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PROGRAM FRAUD CIVIL PENALTIES ACT OF 1985

HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT OF GOVERNMENT MANAGEMENT

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 1134

TO AMEND TITLE 5, UNITED STATES CODE, TO PROVIDE ADMINISTRATIVE CIVIL PENALTIES FOR FALSE CLAIMS AND STATEMENTS MADE TO THE UNITED STATES BY CERTAIN RECIPIENTS OF PROPERTY, SERVICES, OR MONEY FROM THE UNITED STATES, BY PARTIES TO CONTRACTS WITH THE UNITED STATES, OR BY FEDERAL EMPLOYEES, AND FOR OTHER PURPOSES.

JUNE 18, 1985

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PROGRAM FRAUD CIVIL PENALTIES ACT OF 1985

TUESDAY, JUNE 18, 1985

U.S. SENATE,
SUBCOMMITTEE ON OVERSIGHT
OF GOVERNMENT MANAGEMENT,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:36 a.m. in room SD-342 of the Dirksen Senate Office Building, Hon. William S. Cohen (chairman of the subcommittee) presiding.

Present: Senators Cohen, Levin, and Chiles.

Staff present: Susan M. Collins, staff director; Jeffrey A. Minsky, staff investigator; Linda J. Gustitus, minority staff director; Frankie de Vergie, chief clerk; Rachal D. Harlan, assistant chief clerk; and Bob Coakley, professional staff assistant.

OPENING STATEMENT OF SENATOR COHEN

Senator COHEN. The hearing will come to order.

Public patience with fraud in Federal programs has long been exhausted. Abuses ranging from defense contractors submitting false claims to individuals collecting food stamps that do not deserve them undermine public support for a strong national defense and a compassionate assistance program.

Today, the subcommittee is holding a hearing on legislation that I believe would provide an effective tool against fraud in Federal programs.

The Program Fraud Civil Penalties Act of 1985 would provide agencies with an administrative remedy for false, fictitious, or fraudulent claims and statements under $100,000 that the Justice Department has declined to prosecute.

Present law provides criminal and civil penalties for false claims and criminal penalties for false statements. The imposition of these sanctions requires the Justice Department to bring a criminal or civil suit in Federal court.

For small-dollar fraud cases, however, it's often not worth the Department's time and money to go to court. From a cost-benefit perspective, the cost of litigating a small-dollar fraud case will almost always exceed the amount recovered, making it economically impractical for the Justice Department to prosecute. Consequently, the Government is often left without an adequate remedy for small-dollar false claims and statements.

The General Accounting Office found that many such cases fall through the cracks of our judicial system. According to a 1981 GAO report, more than 77,000 fraud cases allegedly were committed against the Government during a 3-year period. Of those cases referred to the Justice Department, however, less than 40 percent were prosecuted.

By failing to prosecute nearly 60 percent of its false claim and statement cases, the Government not only loses money, but also public confidence in its programs. And even when no money is actually lost as a result of a false claim or statement, such as when a nonveteran obtains a VA-guaranteed home loan, the integrity of the program is seriously undermined.

Worse yet, the GAO found that fraud is not limited to any one program or agency, but it is pervasive—ranging from fraud in benefit and assistance programs, such as food stamps, welfare, and student loans, to fraudulent claims for mortgage insurance, crop subsidies, disaster relief programs, and the like.

Fraud also plagues Government contracting, according to Joseph Sherick, the Defense Department inspector general. Last year, Mr. Sherick estimated that his Department alone loses more than $1 billion a year through fraudulent billing practices, the most common being improper overhead expenses charged against Government contracts. Mr. Sherick has characterized the attitude of some contractors as "we stole it fair and square."

While the conviction of General Electric and the continuing saga of General Dynamics are visible examples of the problems in Government contracting, the more typical fraud case involves fewer dollars, draws little public attention, and therefore, is less likely to be prosecuted.

An example is a case in which the Naval Investigative Service identified over $600,000 in fraudulent overpayments on a base maintenance contract. The contractor was found to have deliberately overbilled the Navy on numerous items, but a decision was made to seek criminal prosecution on only $25,000 in false claims. The Justice Department subsequently determined that $25,000 was too small an amount to justify prosecution and the case was declined for both criminal and civil action.

I think this is an example of just one of the cases that now typically fall through the judicial cracks but could be caught by the administrative proceedings established by the Program Fraud Civil Penalties Act. The purposes of the act are to recompense agencies for losses resulting from false claims and statements that would not otherwise be prosecuted, to penalize those who submit false claims and statements, and to deter such fraudulent behavior in the future. In my judgment, such an administrative remedy for small-dollar fraud cases is long overdue.

Under the program fraud legislation, a typical case would begin with an investigation conducted by the agency's investigating official, usually the inspector general. Any findings would then be transmitted to the agency's reviewing official, who would determine whether there is probable cause to conclude that a false, fictitious, or fraudulent claim or statement had been submitted.

And if so, the matter would then be referred to the Justice Department for consideration. The allegations of liability would then be referred to the agency's hearing examiner, usually an administrative law judge, only if the Justice Department either approves the referral or takes no action to disprove it.

The agency would conduct a hearing to determine whether or not the person is liable and the amount of penalty and assessment, if any, to be imposed. A person can be found liable under the bill if he or she "knows or has reason to know" that the claim or statement submitted is false, fictitious, or fraudulent.

The hearing examiner's determination would be based on a "preponderance of the evidence," the standard applied in most civil litigation and administrative proceedings, and a penalty of up to $10,000 for each false claim or statement plus double the amount falsely claimed could be assessed.

The hearing itself would be conducted "on the record," which brings into play the due process safeguards of the Administrative Procedure Act. A person alleged to be liable is entitled to written notice of the allegations. At the hearing, the person has the right to be present, to be represented by counsel, and to present evidence in his or her own behalf. The separation of investigatory and adjudicative functions provided for in the bill ensures impartiality.

In addition to these protections, persons alleged to be liable would also be afforded discovery rights to the extent that the hearing examiner determines that discovery is necessary for the expeditious, fair, and reasonable consideration of the issues. Finally, the person would have the right of judicial review by the U.S. Court of Appeals.

The attractiveness of this administrative mechanism is that we already know that it can work—both expeditiously and fairly. Under the 1981 Civil Monetary Penalties Law, the Department of Health and Human Services is authorized to impose penalties and assessments against health care providers who knowingly or with reason to know submit claims for services not provided as claimed. I look forward to hearing the testimony by the HHS inspector general on his experience with this particular law.

I'd like to add that in drafting the program fraud legislation this year, we endeavored to accommodate the legitimate concerns of opponents of the bill. And the most significant revisions include the following:

No. 1, rewriting the liability section to link the knowledge requirement with the falsity of the claims and statements and to exclude legitimate contract disputes;

No. 2, strengthening the due process protections afforded to persons subject to the administrative proceedings;

And No. 3, clarifying that a finding of probable cause or liability resulting from the administrative proceedings may be grounds for commencing a subsequent administrative action, such as debarment or suspension or other disciplinary action, but will not serve as an automatic trigger for taking such action.

This morning, the subcommittee is going to receive testimony from the Justice Department, the Department of Defense, the Department of Health and Human Services, the Public Contract Law Section of the American Bar Association, and a defense contracting association. I am hopeful that, given this balanced presentation, we will be able to resolve the issues that have hampered past efforts to establish a much-needed administrative mechanism for handling these small-dollar false claims and statements.

As long as the Government continues to tolerate "nickel and dime" frauds, the problem is going to continue to worsen. Passage of the Program Fraud Civil Penalties Act, in my judgment, would demonstrate our resolve to remedy this problem.

Before proceeding with the witnesses, I would yield to my colleague from Florida, Senator Chiles.

OPENING STATEMENT OF SENATOR CHILES

Senator CHILES. Thank you, Mr. Chairman. I simply want to make an observation and a pledge.

I can remember when the idea before this legislation started out—it had to be some 5 years ago, some 2 years after we'd passed the Inspector General Act of 1978—the General Accounting Office reported that there were hundreds of instances where the IG's were referring cases to the Justice Department that just languished.

We did get that, of course, from Health and Human Services. Many of these are small cases, usually false claims, which, individually, Justice did not feel merited their resources, but in the aggregate, amounted to a lot of wasted taxpayers' dollars.

Even the Budget Committee took notice of that and, of course, we were always putting some item in or someone wanted to put some item in on the floor for fraud or waste. But the Budget Committee highlighted this area back to this committee's attention.

Ever since, we've been trying to create a mechanism to handle this where the IG's find something that should be done, but Justice doesn't want or have the capacity to handle it.

I've heard it said that the problem is too many lawyers. I'm one of those. I can remember some of the mark-ups that we had before trying to deal with this. It sounded like a law school convention.

I suspect that in our room today we have a preponderance of lawyers. In fact, Mr. Chairman, I know you as one of the finest lawyers I know.

Senator COHEN. I feel something coming on. [Laughter.]

Senator CHILES. A good lawyer and a fair person—no, that's my observation.

I just think that we've been at this too long. Had we done this 5 years ago when we should have, we would have already saved in small cases perhaps many, many millions, and perhaps billions of dollars.

I just want to pledge you my support. We need to get this job done and put the mechanism in place. I'm delighted to be one of your cosponsors.

Senator COHEN. Thank you very much, Senator Chiles.

Our first witness today is Richard Willard, the Acting Assistant Attorney General for the Civil Division of the Department of Justice.

Mr. Willard is going to present the administration's views on S. 1134.

TESTIMONY OF RICHARD K. WILLARD, ACTING ASSISTANT ATTORNEY GENERAL FOR THE CIVIL DIVISION, DEPARTMENT OF JUSTICE

Mr. WILLARD. Thank you, Mr. Chairman. I understand that my prepared statement will be included in the record.

Senator COHEN. It will be included in full.

Mr. WILLARD. It's a pleasure to appear before the subcommittee to present the administration's views on S. 1134. This bill provides for an administrative remedy for false and fraudulent claims submitted to the Government.

We strongly support this legislation, Mr. Chairman, and want to compliment you and Senator Roth for your leadership in this effort. The administration fully shares Congress' concerns about fraud against the Government, particularly in the area of procurement. In order to strengthen our remedies against such wrongdoers, the administration will soon send to Congress the Fraud Enforcement Act of 1985, a major legislative initiative to reinforce our antifraud efforts, which will include as one of its titles the Program Fraud Civil Penalties Act.

We look foward to working with the committee on this more comprehensive proposal, as well as on S. 1134.

Also, I'd like to note that the Attorney General has given high priority to the investigation and prosecution of complex white collar fraud cases, especially fraud in the area of defense procurement. The Department of Justice is committed to the vigorous pursuit of all available remedies, both civil and criminal, in this important effort.

S. 1134, like its predecessor, S. 1566, would establish an administrative forum to prosecute the submission of false claims and false statements to the United States. We believe that a mechanism for resolution of many fraud matters through administrative proceedings is long overdue. Many of the Government's false claims and statement cases involve relatively small amounts of money compared to matters normally subject to litigation. In these cases, recourse to the Federal courts may be economically unfeasible because the Government cost of litigation may exceed both the actual dollar loss to the Government and the potential recovery in a civil suit may be exceeded by the Government's cost of litigation.

Moreover, the large volume of such small fraud cases would impose an unnecessary burden on the dockets of the Federal courts.

Fortunately, Mr. Chairman, as you noted in your opening statement, legislative efforts in this area can be guided by the experience of the Department of Health and Human Services under the Civil Money Penalty Law, a similar statute which has been in effect for several years. Under that law, HHS has recovered over $15 million in fraudulent overcharges under the Medicare and Medicaid Programs. Inspector General Kusserow, who will be testifying later this morning, and the entire Department, are to be commended for their efforts. HHS's successful experience testifies to the great savings which could be achieved if this authority were extended Governmentwide.

My prepared statement discusses the provisions of the bill which you've introduced, Mr. Chairman. Specifically, it discusses the issues of the scienter requirement, which is based on the False Claims Act, which has been in effect for over 100 years. My statement also discusses the provisions of the bill which provide for due process and fairness in the administrative adjudication of these cases, including the requirement of judicial review, and the fact that the sanctions in the Act are remedial rather than punitive. Finally, I note that the act would not have an automatic effect on suspension and debarment decision which would continue to be handled administratively subject to the discretion of the agencies involved.

While we endorse most of the essential provisions of S. 1134, we do believe the bill could be improved in certain respects. First, we urge the committee to reconsider the desirability of section 804(a)(3), which permits inspectors general and other investigatory officials to use compulsory process to obtain testimonial evidence as part of an investigation.

Second, in the civil fraud area, collection of sums owed is often as difficult as winning a judgment itself. Last year's bill, S. 1566, recognized this difficulty and provided the United States with setoff authority as an aid to collections. We were disappointed to see this provision was not included in this year's bill and would urge the committee to reconsider it.

Third, section 803(f)(2)(F) of the bill provides that if the agency chooses to adopt regulations governing hearings, such regulations, in addition to the full due process rights provided by section 803, must provide for a limited right of discovery.

The right of discovery is not provided under the APA and is rarely available in administrative proceedings. We believe such a discovery is inappropriate in administrative proceedings and will unduly delay the process.

Fourth, because it is not our intention to use this administrative mechanism as a substitute for criminal prosecution, we suggest the bill be amended to clarify that it does not alter existing obligations of agency officials to report evidence of criminal conduct to the Attorney General.

Finally, we have some concern about the amount of penalty which may be assessed under S. 1134. Particularly, we believe there is some uncertainty about the scope of the double damages remedy. The language of the bill is subject to two interpretations—either the damages are equal to twice the entire amount of the claim or twice the amount of the fraudulent portion of the claim.

We feel that the latter reading, which is consistent with judicial interpretations of the Government's remedies under the False Claims Act, is the preferred one.

That concludes my statement, Mr. Chairman. I'd be pleased to answer any questions you or other members of the committee may have.

Senator Cohen. Thank you very much, Mr. Willard. I think you summarized your testimony very nicely.

I would begin by asking you how much would you estimate the Government currently loses by not prosecuting these small-dollar fraud cases through the Justice Department?

Mr. WILLARD. We've tried looking at it a couple of ways. First, we've looked at the experience of HHS, which, under their very limited statute, have recovered $15 million in 1 ½ years. So if there's $15 million to be recovered, or $10 million a year, in one department under those limited programs, it seems to me safe to assume that there are certainly tens, if not hundreds, of millions of dollars potentially available to the Government if this authority were extended Governmentwide.

The other way we've analyzed this question is through the number of smaller fraud cases that are referred for litigation. We've tried to estimate how many cases that currently come through the system might be candidates for an administrative penalty system. We've come up with an estimate that perhaps 1,000 cases a year involving an average of $10,000 to $50,000 a case, might be so referred.

That approach, however, is a little bit misleading because we know a lot of cases never get referred now because they involve such small amounts of money.

So, basically, we can say that we're confident that there are at least tens of millions of dollars out there, and beyond that, we can't be exactly sure.

Senator COHEN. But beyond the dollar amount, is it fair to say that there's very little deterrent if you don't undertake the prosecution of cases? Then you remove the deterrent against contractors continuing to commit small-dollar frauds as such.

Mr. WILLARD. That's certainly true, Mr. Chairman. One of the commendable purposes of this bill is not only to collect money, but also to create a deterrent to prevent the loss from occurring in the first place.

Senator COHEN. Some of the critics of this legislation have said that the Justice Department's declination rate is the consequence of a prosecutorial resource problem. Notwithstanding my colleague's comments that there are too many lawyers, the critics believe that the Justice Department doesn't have enough manpower, womanpower, enough attorneys, to prosecute these cases.

Assuming that we were to double the number of attorneys in the Justice Department, would that make a difference in terms of the Department of Justice prosecuting more of these cases?

Mr. WILLARD. Well, it certainly would, Mr. Chairman. But we question whether that would be cost effective. We have tried to estimate how much it would cost to litigate one of these typical small-fraud cases. Assuming an attorney spends 1 month on a case and, if you take the attorney's cost, the overhead cost, court costs, and the cost of the agency to provide litigation support, we run up expenses of to $15,000 or $20,000 very quickly.

It's simply not cost effective for the Government to spend that kind of money to litigate a case where our recovery may only be $10,000 or $15,000. We believe the remedy provided in this bill would be more cost effective for these kinds of cases.

Senator COHEN. Assuming we gave you twice as many lawyers in the Justice Department—which is not a reasonable proposal in my judgment—but assuming we were, what would be the impact upon the Federal court system?

Mr. WILLARD. Well, that is another issue, Mr. Chairman. You would also have to increase the number of judges and the number of courtrooms, because it would impose a burden on the courts as well to process the cases. If you did not, we would have enormous delays in the court dockets in getting the cases to trial.

An example I gave in my prepared statement was the case involving the claim of about $13,000 in one of these small-fraud cases. It took 6 years to litigate. That's another disadvantage of the court system as opposed to an administrative remedy.

Senator COHEN. How would you compare the cost, as well as the relative investments of time and resources, in going through the court system versus the administrative process?

Mr. WILLARD. Well, the administrative process can be much faster because you don't have the docketing delays and because the process is streamlined. I view this legislation as basically creating an alternative dispute resolution mechanism which has been urged as a remedy to excessive litigation in a lot of contexts in our court system.

Senator COHEN. Well, last year, the ABA raised a concern, and I think you touched upon it in your testimony, about this proposed legislation being more penal than remedial—certainly more penal than any penalty contained in existing civil fraud cases.

Would you characterize this legislation as penal rather than remedial?

Mr. WILLARD. No, Mr. Chairman. I would characterize it as remedial. As I pointed out in my prepared statement, in the case of *United States ex rel. Marcus* v. *Hess*, upon which this bill is based, the Supreme Court has held that the False Claims Act is basically remedial rather than punitive.

For that reason, I believe this bill too would be so construed by the courts. It does provide for double damages plus a fixed forfeiture. But in our view, this is a form of liquidated damages to help make the Government whole for such matters as the cost of investigation and detecting fraud against the Government and thus, is designed really to remedy the situation rather than to impose punishment.

Senator COHEN. What about the provision which would impose a penalty for false statements unrelated to any particular monetary loss on the part of the Government?

Is that then characterized as penal rather than remedial?

Mr. WILLARD. Mr. Chairman, I don't believe so, because even when false statements don't directly involve monetary loss, they do involve expense on the part of the Government in terms of detection and taking preventive action.

One of the examples you gave in your opening statement—involves someone who is not a veteran who falsely receives a VA mortgage—demonstrates that it does cost the Government money to try to detect and prevent those kinds of matters from occurring. And so the provision of a fixed amount of a forfeiture in those cases does, in effect, remedy the problem and make the Government whole for the cost of trying to prevent and detect it.

Senator COHEN. Or if someone, for example, were to certify an application that he or she or the company qualified for a small business set-aside provision just by applying and certifying that they were, in fact, a small business. There might not be any damages to the Government, but it would be a false statement, as such.

Mr. WILLARD. That would be another example, Mr. Chairman. And, again, I think it would be appropriate to characterize it as remedial.

And if I could also add to that, I think to some extent this is a smokescreen, anyway. I'm not sure that—the Supreme Court held in the *Atlas Roofing* case that even if a statute involves a civil penalty, there is not necessarily a right to a trial by jury. In that case, the Occupational Safety and Health Act provided for an administrative remedy.

So even if you were to characterize this act as punitive—which I do not believe it is—that would still not create any due process or other problems.

Senator COHEN. Another major area of controversy over this proposed legislation is the question of knowledge. S. 1134 adopts the standard from the HHS civil monetary penalty law—knows or has reason to know—to clarify that either actual knowledge or constructive knowledge would be required in establishing liability.

Mr. Kusserow is going to testify later that the "reason to know" component is essential to reach those individuals who essentially "play ostrich," by turning away and not looking at the situation, saying, they didn't have actual or constructive knowledge of the wrongdoing.

Mr. Kusserow said that the reason to know standard would not penalize individuals involved in a good faith dispute with the Government concerning the claim.

Do you see any potential for abuse in this standard?

Mr. WILLARD. No, Mr. Chairman. I think that my prepared statement has made it clear, and I'm sure that the legislative history of this bill will make it clear, that it is not intended to penalize contractors for good faith disputes with the Government.

We are concerned that, given the realities of modern corporate structures, responsible officials may arrange deliberately to shield themselves from knowledge or will be reckless in their submission of claims to the Government. We simply have to have a standard that is broader than actual knowledge in order to deal with the realities of the modern contracting process.

Senator COHEN. Mr. Rhett Dawson, who is going to be testifying later on behalf of the Aerospace Industries Association, has interpreted this standard to require "intent" in order to establish liability. Mr. Dawson states that the courts have regularly followed his interpretation of "knows or has reason to know." And I was wondering what the Justice Department's interpretation is. Does the Department interpret "knows or has reason to know" to require intent?

Mr. WILLARD. We don't regard that as being a specific intent requirement at all. We think it does require something more than an innocent mistake. It does require a showing of some kind of deliberate act or fault on the part of the individual.

But it's not the same thing as requiring of intent, and we think that's perfectly appropriate for this kind of a remedial statute. We're not imposing a criminal sanction, although I would point out that there are certain criminal statutes that do not require specific intent.

Senator COHEN. What would be the impact on the administrative process if you had to establish intent?

Mr. WILLARD. It would simply make it much more burdensome to prove the cases. It would require more testimony. It would make the administrative process last longer.

I would point out also, Mr. Chairman, that we will propose amendments to the False Claims Act to clarify that it too contains a "knows or has reason to know" standard because we think this is the appropriate standard for proving fraud against the Government civil cases.

Senator COHEN. The Aerospace Industries Association also maintains that this bill would result, and I'm quoting, "in constantly differing subjective determinations by different agencies to produce drastically disparate results from similar facts."

Do you agree with that statement?

Mr. WILLARD. No, Mr. Chairman. The bill provides a coordinating role for the Department of Justice in these cases. We're prepared to meet our responsibilities to ensure that the act is interpreted in a uniform and reasonable fashion throughout the Government.

We do believe, however, that the individual agencies are best equipped to apply these uniform legal standards to their precise factual situations. For example, the Department of Housing and Urban Development is going to better know what is or is not a false claim or statement in the context of a federally insured mortgage program. And that's why it makes sense for these claims to be administered separately through the agencies with the Justice Department playing a coordinating role.

Senator COHEN. In terms of dealing with disparate results, do you think we ought to have one set penalty, or should there be flexibility involved?

Mr. WILLARD. The Department of Justice has suggested providing for a fixed forfeiture of $5,000 in each case plus double damages. Your bill, Mr. Chairman, provides for more flexibility by stating the forfeiture can be an amount up to $10,000. So it does provide flexibility in the way the forfeiture would be imposed.

Senator COHEN. Well, I guess it raises the issue, would you rather have something fixed in order to reduce any disparity between assessments made by agencies, or should there be some flexibility granted to take into account the severity of the fraudulent or false claim or statement?

That's a question we're trying to balance in terms of whether uniformity in application might prove less equitable than it would to allow some flexibility. But that's something that we'll try to resolve as we go through these hearings.

Just a couple more questions and I will yield to Senator Chiles.

Your recommendations include changing the proposal in the bill to preclude civil discovery because you think it would defeat the purpose of creating this alternative dispute mechanism.

Does limiting the discovery, or at least having the hearing examiner exercise some judgment here as to whether or not discovery would contribute to an expeditious, fair, and reasonable consideration of the issues, solve in any way a part of your problem?

Mr. WILLARD. It certainly ameliorates the problem, Mr. Chairman. The language in the bill very much limits discovery and so goes a long way toward avoiding the problem.

We are still concerned, however, if there is a possibility of discovery, however carefully limited in the drafting of the statute, that it could prove to be a stumbling block for the efficient resolution of these cases. And since discovery is not normally part of the administrative process, and because of the desire to process the cases expeditiously, we believe it would not be appropriate to include a right to discovery.

Senator COHEN. I have several more questions. I'd like to yield at this time to Senator Chiles.

Senator CHILES. Go right ahead.

Senator COHEN. All right. I will continue. A couple of other points that you've made about set-offs.

The bill we had last year did allow the Government to set-off on any obligation it might owe to the individuals involved. One of the reasons why, in my judgment, at least, we deleted that this year is based upon testimony from the IRS Commissioner, Roscoe Egger, who in other hearings stated that the use of the IRS for nontax purposes may lead to an increase in tax evasion or cheating itself. He based that statement on an analysis of some 400,000 taxpayers' situations.

Does the Justice Department anticipate any adverse consequences, such as a decrease in taxpayer compliance, if we allow set-offs?

Mr. WILLARD. Our view, Mr. Chairman is that the bill would not repeal section 2653 of the Deficit Reduction Act of 1984, which allows set-offs against tax refunds. So, ironically, as drafted now, the bill would allow set-offs against tax refunds, but not against any other kind of Government payments. So, I think if your concern was the tax refund situation, the result is exactly the opposite of what may have been intended.

Basically, our view is that in the small fraud cases particularly, the party owing the money is likely to present a collection problem. That's another reason, by the way, that the Justice Department frequently does not go forward on these cases. They consume an inordinate amount of time and money while in litigation, but once you get a judgment for $10,000 or $15,000, it may be very difficult to collect. If the money is owed by the recipient of a small business loan or a federally insured mortgage or some other kind of Federal program, that recipient is not likely to have large assets that can easily be executed against for a judgment. For that reason, we believe that if this is going to be an effective remedy, that the set-off is really a vital provision.

Senator COHEN. The Aerospace Industries Association also contends that this bill would allow suspension and debarment for the most innocuous of unintentional omissions.

Frankly, I don't understand how they could reach that conclusion. But I think it's quite clear that we tried to indicate that any proceeding under this particular bill would not automatically trigger debarment and suspension proceedings. It would be a factor that would be taken into account, but would not automatically trigger it.

The ABA recommends in its formal statement that section 802 of the bill should be amended to clarify that a finding of liability resulting from these proceedings shall not be determinative of a person's present responsibility for suspension for debarment consideration.

Do you have any difficulty with that?

Mr. WILLARD. Yes, Mr. Chairman. We believe suspension and debarment should be handled separately from this bill and that if Congress wants to legislate in this area, which is currently provided largely as an administrative remedy under regulations, that Congress should address that issue separately rather than restricting how the bill can be used.

As you have pointed out Mr. Chairman, this bill would not result in any automatic suspension or debarment, rather, that issue would continue to be judged under the standards of those regulations as now in place. I think this really is a red herring, and that there is no need for this legislation to address the suspension or debarment process.

Senator COHEN. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

First, on the question of whether the hearing examiner should be an administrative law judge—I don't know whether you've testified on that already. If you have, I would rely on the record relative to it—but do you have an opinion on the question as to whether or not the hearing examiner should be an administrative law judge or otherwise trained in the law?

Mr. WILLARD. Mr. Chairman, I think that that really is a matter on which the agency should have some flexibility. The hearing examiner certainly should be an impartial official and there should be limitations as the bill provides on such matters as ex parte contacts, to ensure a neutral adjudication. We don't believe, however, that the Constitution or fairness require that the hearing officer necessarily has to be an administrative law judge.

Senator LEVIN. Do we have other examples where a forfeiture can be provided where it is not an administrative law judge who is doing the ruling?

Mr. WILLARD. Well, there are many hearing officers around the Government who are not formally administrative law judges. For example——

Senator LEVIN. Can they impose forfeitures, do we know?

Mr. WILLARD. I would have to provide that for the record, Senator.[1]

Senator LEVIN. Would you do that? If you could let us know for the record what other hearing officers or hearing examiners do have that power in the Government, it would be helpful.

Should we require that the hearing officer be an attorney?

Mr. WILLARD. I personally have no objection to that if the committee feels that that would be appropriate. I don't see that that's constitutionally required for this kind of a small case. I don't know that that would be an insurmountable obstacle. As Senator Chiles noted earlier in the hearing, we seem to have a surplus of lawyers around the country and so, I don't think that would pose an insurmountable difficulty.

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[1] See p. 158.

Senator **Levin**. Do we have any examples where hearing officers ruling in these kinds of cases on claims anywhere are not attorneys, whether in the Federal Government or in the State governments or in local governments or small claims courts or anything like that?

Do we have any examples?

Mr. **Willard**. Yes, Senator. In many small claims courts and low level State and local courts, the presiding officials, magistrates, or whatever, are not required to be attorneys.

Again, we can provide precedent on the constitutionality of that for the record.[1]

Senator **Levin**. All right. That would be helpful.

The $10,000 forfeiture which is provided for in our bill, I gather is higher than the forfeiture in the False Claims Act.

Mr. **Willard**. That is correct, although we believe the forfeiture in the False Claims Act should also be increased to reflect inflation since that act was adopted in 1963.

Senator **Levin**. All right. Assuming we build a COLA into the False Claims Act and it brings the forfeiture above $10,000, then my question would no longer be relevant. But if, for one reason or another, the False Claims Act is not amended simultaneously herewith to provide for a greater forfeiture than this, would we not have an equal protection argument, that here, an act which is for a false claim of less than $100,000 has a greater forfeiture than a false claim of greater than $100,000?

Mr. **Willard**. No, Senator, I don't believe that there is any constitutional problem. Among other things, it may be thought that the smaller claims require a larger forfeiture because of the relatively higher administrative processing costs as compared to larger claims.

I don't see any kind of suspect category involved here which might lead a court to apply a higher degree of constitutional scrutiny than the usual rationality test. And under that standard, I think the courts generally defer very much to the legislative judgment in line drawing in these situations.

Senator **Levin**. Well, the False Claims Act would still be applicable if the Justice Department wanted to apply it to a claim under $100,000; right?

Mr. **Willard**. That is correct, Senator.

Senator **Levin**. So we'd have one act applying to a false claim under $100,000 which has a forfeiture of $2,000, assuming it's not COLA'd, and another administrative enforcement provision with a forfeiture of $10,000.

Let's assume we finally write the $10,000 figure in, or a $5,000, or whatever we finally put in there.

You don't think a court's going to have trouble with the equal protection argument against that?

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[1] See p. 158.

Mr. **Willard**. No, Senator, I don't.

Senator **Levin**. Doesn't it seem arbitrary to you that a false claim of $50,000 has a bigger forfeiture than a false claim of $5 million?

Mr. **Willard**. Senator, there are many statutes that have distinctions of this nature, among them disparity in sentencing provisions in the criminal law.

I agree with you that, from a policy standpoint, it's not a good thing. We are proposing that the False Claims Act be amended to provide the same forfeiture as under this bill. But I don't believe that the courts would find this bill to be unconstitutional merely because it provides a different forfeiture amount than under the False Claims Act.

Senator **Levin**. Well, since you're providing so many things for the record, I'd like to see some evidence for that, where what would be commonly perceived as being a smaller violation, has a greater forfeiture than a larger or a more major or a more significant violation. I'd like to see some support for that.

Mr. **Willard**. We'd be happy to provide that, Senator.[1]

Senator **Levin**. I agree with you, by the way. I do think that we ought to try to get the other forfeiture provision amended. I don't know whether we can do that in this bill or whether it requires a separate bill going to a different committee. I'm not sure.

I'm somewhat troubled by the fact that the reviewing official is selected by the same agency head who is going to review the decision of the hearing officer. Does that create any difficulty legally? If the person, in effect, who selects the person who's going to decide whether to proceed to a hearing is the same person who reviews the judgment at that hearing in a quasi-judicial or appellate way, does that create a problem under due process or—well, I guess it would be due process.

Mr. **Willard**. I don't see a problem of due process. It's very common——

Senator **Levin**. Or any other constitutional problem.

Mr. **Willard**. I don't see one. It's fairly common in administrative law for decisions to be reviewed by agency heads who are also responsible for selecting and supervising staff members who may prosecute the cases.

For example, most of the independent regulatory commissions both supervise staff which develop and prosecute cases before them, and then also sit as an administrative appellate body to review the initial decision of the hearing officer and make the final decision of the agency. I think in those situations, as here, an important safeguard is provided by the right of judicial review in an article III court.

Senator **Levin**. But, in the SEC situation, the members of the SEC are selected by the President. In that case, they're selected by a different person than the person—the agency director—who selects the prosecutorial staff. There is a division there, isn't there?

Mr. **Willard**. There is a division in terms of contacts between the prosecutive staff and the initial——

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[1] See p. 158.

Senator LEVIN. Not contacts. I'm talking about a separate appointing authority.

Mr. WILLARD. The agency prosecuting staff is selected by and supervised by people who are selected usually, by the chairman, and sometimes by the entire membership of the Commission.

For example, in the Federal Trade Commission, the head of the prosecutive staff component is selected by the chairman, with the approval of the other commissioners.

Senator LEVIN. And the Commission sits on appeal of the decision of the staff?

Mr. WILLARD. Yes, after the staff prosecutes the case before an initial hearing officer.

Senator LEVIN. I just have one other question. I don't know how you want to allocate time here.

Senator COHEN. The time expired 5 minutes ago.

Senator LEVIN. Oh. Then I don't have any other quesions.

Senator COHEN. No, really, go ahead. Ask your question.

Senator LEVIN. I can come back.

Senator CHILES. I don't have any questions.

Senator LEVIN. Shall I finish, then? It's this question of evidence of the intent, of the knowledge, whether you knew or "has reason to know" of the falsity claim.

I'd be interested to know whether or not you would interpret that to mean, knew or should have known.

Are you familiar with the exact words in our bill?

Mr. WILLARD. I believe that is the language in the bill.

Senator LEVIN. I think the language in the bill is if any person makes a claim that the person knows or has reason to know.

Mr. WILLARD. Right. I think that would——

Senator LEVIN. Does that mean should have known?

Mr. WILLARD. I think it would include that.

Senator LEVIN. What else does it mean?

Mr. WILLARD. I think it would include a situation, for example, where a responsible person deliberately insulated himself from knowledge by structuring the corporate affairs in a way that he was deliberately shielded from knowledge of the falsity of a claim or statement submitted by his subordinates.

Senator COHEN. An example might be E.F. Hutton, by way of example?

Mr. WILLARD. I'm not familiar with the facts of that case, so I couldn't comment on it. But another situation would be where the responsible person was reckless in submitting a claim without taking the appropriate steps to determine whether or not it was false.

Senator LEVIN. A later witness is going to, according to his testimony, argue that we ought to adopt an interpretation of the restatement of torts.

Are you familiar with the intricacies of that issue?

Mr. WILLARD. I——

Senator LEVIN. Let me read you the definition from the restatement of torts, or it might be the restatement of agency. I'm not sure. But one of the restatements says that "reason to know," and those are the words that we use in our bill, "reason to know imports no duty to ascertain facts, not to be deduced as inferences from facts already known. One has reason to know a fact only," according to the restatement, as quoted in this testimony, "if a reasonable person in his position would infer such fact from the facts already known to him."

That is in contrast to another definition, which is a "should have known" standard, a little bit different from the restatement.

Are you in a position to say that we should or should not adopt the narrower interpretation in the restatement of agency this morning? And if not, would you give us your comment for the record?

Mr. **Willard**. I would like to have the opportunity to give a comment for the record because we have a number of standards floating around there. Of course, they have been interpreted in different ways by the courts in different contexts.

I think, obviously, what would be controlling here would be the intent of Congress. So, the committee should make clear in the legislative history what the committee intends to be the standard for interpreting the language in this bill.

Senator **Levin**. I think I'd like your recommendation on that issue as to what we should adopt as our definition. I think it's important in writing a bill that we be as precise as we can on this issue. It's a very critical issue. It sounds technical, but having been in the position on both sides of these kinds of cases, I think it would be useful if we had your recommendation so that if we decide to be very precise in our history on that matter, that we at least have that option and can base it on your recommendation if we so choose.

Mr. **Willard**. We would be happy to provide that, Senator.

Senator **Levin**. Thank you.

Senator **Cohen**. Of course, the restatement of torts is not necessarily a matter of law. The courts may or may not draw upon it. My understanding is that a majority of courts do not require specific intent in interpreting statutes with standards such as know or has reason to know.

Mr. **Willard**. Well, that is certainly true, Mr. Chairman. I don't think that Senator Levin was implying that because it imposes additional limitations, but does not limit it strictly to actual knowledge.

Senator **Cohen**. What we're trying to get at basically, not only with you, but everybody in the audience here, is a situation in which a major contractor who builds a ship or an aircraft with hundreds, if not thousands, of subcontractors, whose bids he is not intimately familiar with; yet, he presents his final package to the Government. Then later, we find out that they're charging $600 for an ashtray or a toilet seat, or whatever it might be. Through this proposed legislation, we can then go back to the major contractor to determine whether he either knew or had reason to know of the false claim.

And he typically says, "wait a minute. I had no basis of knowledge under these circumstances. I can't be expected to monitor every single spare part that goes into the construction of a ship or an aircraft or whatever else."

That is part of the dilemma that we are seeking to resolve. I think Senator Levin is raising some legitimate questions—to what degree do we require those contractors to have reason to know? Is there some affirmative duty to do more than simply submit a bid without looking at the underlying facts, without looking at the reasonability of those costs and simply passing them along?

I think that's one of the critical elements in this legislation. Who do we shift the burden to? We shift it to the Government to say that we've got to find it out, but you didn't know? Do we take the E.F. Hutton situation where the top executive said, we didn't know that that was going on? We didn't know that all that money was being floated out there on these checks. We had no knowledge.

And do you say, wait 1 minute. Do the top executives have a higher obligation? Did they have reason to know? Do they have knowledge or should there have been knowledge?

That's the tough issue we're getting at here and it seems to me, in view of the amount of false or fictitious claims that have been, I think, perpetrated against the Government and not prosecuted, that there should be some shifting of the burden there.

Mr. **Willard**. We clearly are in agreement that it should be broader than actual knowledge. And we are also preparing to submit an amendment to the False Claims Act that would track this language because the False Claims Act now speaks in terms of knowing submission and does not include a reason-to-know standard.

I think this will be very helpful for the committee to look into this issue, because whatever you do under this bill, we will also propose under the False Claims Act.

Senator **Levin**. Mr. Chairman, I would agree with you, by the way, that we should not automatically adopt any restatement or any court case for that matter. That's just one option that's open to us. But I am interested in the Justice Department's recommendation on what standard we should adopt.

For instance, would we require that the absence of knowledge be reckless? Would we be satisfied if the absence of knowledge was negligent, assuming there's no knowledge. If there's knowledge, we've taken care of the issue. But if it's reason to know, would we say, well, there was an ability to know. You had the capacity of learning. It was within your control.

Do we go beyond that and say, you should have known and you were negligent in not knowing? Or do we go to the next level of maybe saying, you were reckless in not knowing?

Senator **Cohen**. Gross negligence.

Senator **Levin**. Or grossly negligent. I jumped a step and maybe a couple others. You're right. There may be a couple of levels I missed in there.

But, at any rate, I think we should delve into this and whatever advice the Justice Department can give to us on it, I think would be helpful.

Thank you, Mr. Chairman.

Senator **Cohen**. Just one final point. I did introduce a separate bill to raise the False Claims Act forfeiture to $10,000, but that is now before the Judiciary Committee.

Mr. Willard, thank you very much. You've been very helpful.

[Mr. Willard's prepared statement follows:]

PREPARED STATEMENT OF RICHARD K. WILLARD

It is a pleasure to appear before the Subcommittee to present the Administration's views on S. 1134, the Program Fraud Civil Penalties Act, a bill to provide for an administrative remedy for false and fraudulent claims submitted to the government. We strongly support this legislation, Mr. Chairman, and want to compliment you and Senator Roth for your leadership in this area. I should stress at the outset that the Administration fully shares Congress's concern about false claims and statements made to the government. In order to strengthen our remedies against such wrongdoers, the Administration will soon send to Congress the "Fraud Enforcement Act of 1985," a major legislative initiative to reinforce our anti-fraud efforts. We look forward to working with the Committee on this proposal, as well as S. 1134.

I.

Before turning to the provisions of your bill, Mr. Chairman, I would like to place this legislation into context by reviewing the Justice Department's role in the investigation and prosecution of false and fraudulent claims. The need for S. 1134 becomes apparent when seen in relation to the Justice Department's large and growing responsibilities for the prosecution of complex, white-collar fraud cases. It is critical that we be able to delegate the smaller civil fraud cases to departments and agencies if we are to meet our other obligations.

In the last fiscal year, the thirty attorneys in the fraud section of the Civil Division obtained judgments and settlements in excess of $60 million, a significant improvement over prior years. We have 853 cases currently pending in the Civil Division and our recoveries average in the neighborhood of $1 million for each case which we deem to warrant civil action. Additional hundreds of False Claims Act cases are delegated to the United States Attorneys' offices each year.

As you know, Mr. Chairman, the United States has both civil and criminal remedies which it may pursue in prosecuting fraud. While we should never neglect the potential for criminal sanctions, especially in particularly egregious cases, civil sanctions can be equally powerful. As a general rule, our civil fraud prosecution effort is only as good as the criminal and administrative investigations on which nearly all civil fraud cases are based. FBI reports are one major source of leads. However, in recent years, the Inspectors General have provided a growing share of our civil fraud referrals.

The various civil remedies available to us provide a substantial deterrent to the submission of false and fraudulent claims. Because of the double-damages remedy in the False Claims Act, the government can often recover substantial sums in such prosecutions. Finally, because it requires a lower burden of proof, a civil action may be a more realistic course in close cases.

A diligent and tenacious anti-fraud effort serves to reinforce public confidence in the integrity and efficiency of government programs. At a recent speech in Boston, the Attorney General reiterated the need to aggressively prosecute white-collar crime. He noted that fraud committed against the United States, particularly fraud in defense procurement, has and will continue to receive high priority by the Department.

With that as background, Mr. Chairman, I will now turn my attention to S. 1134.

II.

S. 1134, like S. 1566, the predecessor bill introduced in the last Congress, would establish an administrative forum to prosecute the submission of false claims and false statements to the United States. We believe that a mechanism for resolution of many fraud matters through administrative proceedings is long overdue. Many of the government's false claims and false statement cases involve relatively small amounts of money compared to matters normally subject to litigation. In these cases, recourse in the federal courts may be economically unfeasible because both the actual dollar loss to the government and the potential recovery in a civil suit may be exceeded by the government's cost of litigation. Moreover, the large volume of such small fraud cases which could be brought would impose an unnecessary burden on the dockets of the federal courts.

Several cases illustrate the types of matters for which these administrative proceedings are best suited.

> --In the first case, we brought a False Claims Act suit against several real estate brokers and a mortgage company for fraudulently inducing the Veterans Administration to guarantee three mortgage loans. The VA sustained damages of $13,100 on the three loans. While we ultimately recovered well in excess of that amount under the False Claims Act, the congested nature of the district court's docket meant that the litigation took over six years to conclude.
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> --Numerous matters are referred to the Department involving, for example, FHA-insured home improvement loans obtained through fraud, social security or CHAMPUS benefits obtained through misrepresentations regarding eligibility, or fraudulent overcharges on small contracts in which traditional civil and criminal litigation are simply impracticable because of the size of the government's claims and the large number of such cases.

Administrative resolution of such small cases will, in our view, address this problem by establishing an expeditious and inexpensive method of resolving them. At the same time, administrative resolution of smaller cases would permit a more efficient allocation of the resources of the Department of Justice, thus enhancing the Administration's efforts to control program fraud.

Fortunately, legislative efforts in this area can be guided by the experience of the Department of Health and Human Services under the Civil Money Penalty Law, 42 U.S.C. 1320a-7a, a similar administrative money penalty statute which has been in effect for several years. Under that law, HHS has recovered over $15 million in fraudulent overcharges under the medicare and medicaid programs. Inspector General Kusserow and the entire Department are to be commended for their efforts. HHS's successful experience testifies to the great savings which could be achieved if this authority were extended government-wide.

A particularly important issue posed by this legislation is the element of scienter necessary to prove a violation. Section 802 does not require the imposition of civil penalties simply because a claim or statement is false. As subsection (a) provides, a false claim or statement must be knowingly made, or knowingly caused to be made, before liability attaches. This element of scienter -- in this context, knowledge of the falsity of the claim or statement -- is central to the liability-defining provisions of section 802. It has long found expression in the False Claims Act, and insures that the bill will not punish contractors who have honest disputes with the government. Under the bill, just as under the False Claims Act, a contractor who, through negligence or misinformation, submits erroneous data to the United States, would not be subject to liability. However, a contractor who submits erroneous data would be liable if he knew, or had reason to know, that it was erroneous when he submitted it.

We believe that these well-developed scienter concepts in section 802 fully protect honest contractors. The False Claims Act, upon which section 802 draws, has been in place since 1863, and we are unaware of any case under the Act in which a contractor has been punished for an honest dispute with the government. We accordingly see no need to engraft upon the existing scienter standard in section 802 another requirement that a knowingly false claim must be accompanied by an intent to defraud. In our experience, intent requirements in the civil area lead to confusion and impose an overly-stringent burden upon the government. The False Claims Act is not generally interpreted to require a showing of intent, see, e.g., United States v. Cooperative Grain & Supply Co., 476 F.2d 47 (8th Cir. 1973), and we do not believe that such an intent requirement should be imposed here.

We believe that the administrative proceedings outlined in section 803 preserve full due process rights, including the rights to notice, cross examination, representation by counsel and determination by an impartial hearing officer, and thus will withstand constitutional challenge. The use of a hearing examiner, or Administrative Law Judge, to compile a factual record and make an initial determination is a common, legally unobjectionable method to administer federal programs. Critics of the use of hearing examiners can point to no legal precedent questioning this administrative hearing mechanism, and, in fact, it has consistently been upheld against court challenge. See, Butz v. Economou, 438 U.S. 478, 513-4 (1978); NLRB v. Permanent Label Corp., 687 F.2d 512, 527, (Aldisert, C.J., concurring).

Criticism of the hearing examiner's supposed lack of independence conveniently ignores these well established precedents as well as several protections built into S. 1134. While the hearing examiner would be an employee of the agency, section 803(f)(2)(C) of the bill assures the hearing examiner an appropriate level of independence by providing that he shall not be subject to the supervision of the investigating or reviewing official, and could not have secret communications with such officials. The bill thus incorporates the generally accepted protections required by the Administrative Procedures Act. And, of course, any adjudication of liability under this bill would be subject to independent review in the Court of Appeals by an Article III judge.

In light of the Supreme Court's holding in Atlas Roofing Co. v. Occupational Safety and Health Administration, 430 U.S. 442 (1977), we do not believe that these proceedings would violate the Seventh Amendment's guarantee of trial by jury. In Atlas Roofing, the Court rejected a Seventh Amendment challenge to the administrative penalty provisions of the

Occupational Safety and Health Act of 1970 because it concluded that Congress had created new rights which did not exist at common law when the Amendment was adopted. The Court held that:

> when Congress creates new statutory "public rights," it may assign their adjudication to an administrative agency with which a jury trial would be incompatible, without violating the Seventh Amendment's injunction that jury trial is to be "preserved" in "suits at common law".

430 U.S. at 455. The rights created here are not co-extensive with any common law cause of action known when the Seventh Amendment was adopted. In addition, we believe that this statute may, like the False Claims Act, be characterized as a "remedial" statute imposing a "civil sanction". See United States ex rel. Marcus v. Hess, 317 U.S. 537 (1943). Given these considerations, the administrative proceedings do not deny unconstitutionally trial by jury.

With respect to this last point, I note that some have suggested that because S. 1134 provides for double damages, it can no longer be viewed as "remedial" and, instead, must be classified as "punitive", presumedly requiring a criminal standard of intent and burden of proof. However, this analysis of the bill is overly-simplistic and does not comport with traditional practice and applicable precedent, including several decisions of the Supreme Court.

Double damages serve an appropriate remedial purpose in several respects. Because of the deceptive and concealed nature of fraud, the government will rarely be able to prove the entirety of its loss. Thus, by establishing a form of "liquidated damages," this provision insures that the government will be made whole. Second, the double-damages provision partially compensates the government for its costs of investigation and prosecution. Finally, this provision has a socially useful deterrent effect.

In 1943, the Supreme Court was called upon to decide just this issue relative to a nearly identical provision in the False Claims Act. The Court unequivocally ruled that the double damage provision of that Act was a permissible statutory enactment, civil and remedial in nature and consistent with other statutes, such as the treble damage provisions of the civil antitrust laws. Writing for the Court, Justice Black stated:

> We cannot say that the remedy now before us requiring payment of a lump sum and double damages will do more than afford the government complete indemnity for the injuries done it. *** Quite aside from its interest as preserver of the peace, the government when spending its money has the same interest in protecting itself from fraudulent practices as it has in protecting any citizen from the frauds which may be practiced upon him.

U.S. ex. rel. Marcus v. Hess, 317 U.S. 537, 549-50 (1943). See also, Day v. Woodworth, 54 U.S. (13 Howard) 361, 371

(18561); Missouri Pacific Railway Co. v. Humes, 115 U.S. 512, 523 (1885).

Finally, questions were raised in the last Congress as to the effect which a finding of liability under this Act would have on a subsequent administrative proceeding to suspend or debar a contractor. In the past, such an amendment has been proposed with the stated objective of preventing the use of a civil penalty judgment in debarment or suspension proceedings. We believe that amending the bill to deny any evidentiary value to a civil penalty judgment in any administrative, civil or criminal proceeding is wholly inappropriate. The civil penalty proceedings envisioned by the bill will afford a full measure of due process protections, as well as the opportunity for judicial review of the proceedings. In view of this consideration, we believe that there is no justification for disturbing the normal rules of res judicata and collateral estoppel, and requiring another tribunal to go through the costly exercise of retrying the same facts that have already been established under the same standard of proof in a civil penalty proceeding.

In addition, we believe that it is important to note that a contractor would always be free to argue the question of remedy in a suspension or debarment proceeding. According res judicata or collateral estoppel effect to the facts underlying a civil penalty judgment in a later suspension or debarment proceeding would not necessarily establish that suspension or debarment was the appropriate remedy. A contractor would still have the opportunity to argue that he should not be suspended or debarred and that some lesser sanction -- or no sanction at all -- should be imposed.

III.

While we thus endorse many of the essential provisions of S. 1134, we believe that the bill could be improved along certain lines.

First, we urge the Committee to reconsider the desirability of section 804(a)(3), which permits Inspectors General and other investigatory officials to use compulsory process to obtain testimonial evidence as part of an investigation. Under the existing provisions of the Inspector General Act of 1978, Inspectors General are authorized to compel production of documentary evidence. Neither the Inspectors General, nor the Federal Bureau of Investigation -- the government's principal law enforcement investigatory agency -- currently issue investigative subpoenas to compel testimony. The potential for the unlimited exercise of testimonial subpoena powers during investigations might raise due process issues as well as interfere with the criminal investigation process. In addition, there would be no central coordinating authority so as to ensure consistency of standards and implementation. In this manner, section 804(a)(3) could adversely affect coordinated law enforcement. The Administration urges that the Committee delete section 804(a)(3) from the bill.

Second, in the civil fraud area, collection of sums owed is often as difficult as winning a judgment itself. Last year's bill, S. 1566, recognized this difficulty and provided the United States with setoff authority to aid in collections, thus clarifying and reinforcing our setoff authority under common law. The government should be authorized to collect judgments obtained under the Program Fraud proceeding by deduction from amounts otherwise owed by the United States. We were disappointed to see that this provision was not included in S. 1134, and would urge the Committee to restore it. Incidentally, under section 2653 of the Deficit Reduction Act of 1984, the United States was given authority to collect debts owed to it (including judgments such as this) from tax refunds.

Third, section 803(f)(2)(F) of the bill provides that if the agency chooses to adopt regulations governing hearings (as opposed to simply following the requirements of the APA), such regulations, in addition to the full due process rights provided by section 803, must provide for a right of discovery, "to the extent that the hearing examiner determines that such discovery is necessary for the expeditious, fair and reasonable consideration of the issues." The right to discovery is not provided under the APA and is rarely available in administrative hearings. We believe that discovery is inappropriate in administrative proceedings and will unduly delay the process. Opening this streamlined administrative process to the abuses inherent in civil discovery would defeat the purpose of such an alternative dispute resolution mechanism. We do not believe that the right of discovery should be available here.

Fourth, because it is not our intention to use this administrative mechanism as a substitute for criminal prosecution, we suggest that the bill be amended to clarify that it does not alter existing obligations of agency officials (especially the IGs) to report evidence of criminal conduct to the Attorney General. The investigating official should report evidence of fraud to the Department of Justice as soon as it comes to his attention, and certainly at the same time that he refers a case to a reviewing official. Consistent with the IGs' existing responsibilities under the 1978 Inspector General Act, this would permit us to determine not only whether the case should be prosecuted civilly under the False Claims Act, but also whether to bring a criminal fraud prosecution. Similarly, the reviewing official should not be able to settle a case without informing the Department of Justice.

Finally, we have some concern about the amount of the penalty which may be assessed under S. 1134. The False Claims Act provides a $2,000 forfeiture (in addition to double damages) for each false claim. We agree that this amount (which has been unchanged since 1863) should be adjusted upward, but believe that a $5,000 forfeiture would be more appropriate than the $10,000 amount contained in the bill.

More seriously, we are uncertain about the scope of the double-damages remedy. The bill provides that a person convicted "shall also be subject to an assessment, in lieu of damages sustained by the United States because of such claim, of not more than twice the amount of such claim." § 802(a)(1) and (2). This phrase is subject to two interpretations: the damages are equal to either twice the entire amount of the claim, or to twice the amount of the fraudulent portion of the claim. We feel that the latter reading, which is consistent with judicial interpretations of the government's remedies under the False Claims Act, is the preferred one. Under the jurisdictional section, § 803(c), this Act may be used for any claim where the amount fraudulently requested is less than $100,000. Thus, a claim for a $20-million airplane which includes a fraudulent request in the amount of $5,000 could be adjudicated under S. 1134. While such fraud should be punished, we think that a $40-million, double-damage assessment clearly would be excessive. We believe that the amount of the penalty should also reflect this jurisdictional limit, lest it be used to assess truly disproportionate penalties.

That concludes my prepared statement, and I would be happy to answer any questions.

Senator COHEN. Our next witness is Richard Kusserow, the inspector general of the Department of Health and Human Services. Mr. Kusserow also serves as chairman of the legislation committee on the President's Council on Integrity and Efficiency and has been, I must say, very helpful to this subcommittee in drafting S. 1134.

Mr. Kusserow, welcome.

TESTIMONY OF RICHARD P. KUSSEROW, INSPECTOR GENERAL, DEPARTMENT OF HEALTH AND HUMAN SERVICES

Mr. KUSSEROW. Mr. Chairman and members of the subcommittee, I would like to thank you for the opportunity to appear before you and provide comments on the proposed Program Fraud and Civil Penalties Act of 1985. In November 1983, I testified before this committee in support of a similar bill and my support continues. I'm pleased that this year, in my capacity as chairman of the legislation committee of the President's Council on Integrity and Efficiency, I can also provide the committee with the strong endorsement of civil monetary penalties legislation by the entire inspector general community.

I have today a joint statement of the views of the statutory inspectors general and with your permission, Mr. Chairman, I would like to submit this joint statement, together with my own full statement for inclusion in the record.[1]

Senator COHEN. That will be included in the record.

Mr. KUSSEROW. I also have today individual statements for the record submitted by John Martin and Sherman Funk, the inspectors general at EPA and Commerce, respectively, and I'd like to submit them for the record as well.[2]

Finally, I'm also pleased to note that the President has adopted the recommendation of the inspectors general and has included a Governmentwide civil money penalty proposal in his management improvement package.

As you know, since 1981, statutory authority has existed for the inspector general of HHS to levy administrative assessments and penalties against those who file false or otherwise improper claims for payment in the Medicare, Medicaid, maternal and child health care programs of our Department. This statute has served as a prototype for possible Governmentwide application and the program to date has proven, in our judgment, to be a resounding success.

The most tangible indication of the success of the program is, of course, the money recovered from fraudulent health care providers. This is in addition to whatever deterrent effect that comes as well.

In this regard, I'm pleased to inform the committee that in the last 21 months since the implementation of the program, we have imposed penalties and assessments or negotiated settlements totaling in excess of $15 million, all of which are dollars that are returned to the programs or to the general revenue. And more cases are falling into the system every day. As indicated by the chart, the majority of the cases are settled prior to the issuance of the demand letter. We believe that this high ratio of settlements is a clear indication of both the high quality of the investigations, as well as the negotiations, under the CMP Program. This success is further verified by the fact that in the first three cases adjudicated in the due process hearings by the administrative law judges of our Department, our position has been sustained.

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[1] See p. 290.

[2] See pp. 309 and 313.

The following cases are illustrative of the kinds of fraudulent conduct that may be successfully sanctioned under our CMP authority.

In the first case, we had a chiropractor who owned and operated a clinic in Florida, engaged in a large-scale scheme to defraud the Medicare Program by falsely representing ineligible chiropractic services as reimbursable medical services. In executing this scheme, that spanned several years and involved thousands of claims, the chiropractor billed for unallowable services under the names of physicians who not only never performed the services in question, but were not employed by the clinic at the time the services were rendered. On May 15 of this year, an administrative law judge awarded the Department nearly $1.8 million in penalties and assessments against this chiropractor.

In another case, the Department was awarded $156,136 in penalties and assessments against a Kansas nursing home operator who had included numerous false claims in his cost reports for four different nursing homes he operated. The operator created false invoices to support fictitious entries in his cost reports, including such items as lawn care services, food, housekeeping, dietary supplies, linens and so forth, when such services were never sought, nor provided.

And then just recently, in a case involving a pharmacist in Louisiana who, in filing prescriptions for Medicaid patients, substituted generic drugs for brand name pharmaceuticals, the Department was awarded $44,000 in penalties.

Given the success of our CMPL Program, it's not surprising that we're strong advocates of extension of similar authority to other programs administered by our Department and to other agencies throughout the Federal Government.

For too long, many providers of goods and services to the Government have been playing a game of "catch me if you can." We are convinced that this administrative authority is a sorely needed alternative to the judicial resolution of fraud against the Government. We are equally convinced that such governmentwide authority, if aggressively implemented and modeled along the lines of our successful prototype, could provide a significant deterrent to those who would defraud the United States.

Many examples of possible application of the proposed civil monetary penalty authority are included in the joint statement of the inspector general being submitted for the record. These examples bring home the fact that authority to impose administrative penalties for fraud is not merely a desirable adjunct to criminal-civil court action, but in some cases, it would be the only effective sanction against entities who defraud the Government.

In our judgment, the current bill contains several valuable improvements over its predecessor, S. 1566, which may warrant comment. In most cases, these improvements take in the experience of HHS CMPL Program which we believe is a wise approach, given the demonstration that our statute actually does work, both in achieving the Government's objectives and achieving fundamental fairness for the accused wrong-doers.

Foremost among the improvements is the modification of the standard of liability in section 802 to authorize the Government to impose penalties and assessments when a person doing business with the United States submits claims or statements that he "knows or has reason to know" are false. This standard is identical to that already included in the CMPL pertaining to HHS. We believe this standard is essential to reach conduct by individuals who would deliberately avoid finding out what the applicable rules or standards are, or pretend not to know what they are, and then seek to hide behind their ignorance.

For example, if a billing clerk for a clinic blatantly falsifies a Medicare claim for reimbursement with a tacit understanding that they were expected to do so by the principal, and the attending physician signs and submits that claim without reading it, the physician could face liability under our CMPL for having reason to know that, in fact, the claim was false. His failure to read the claim and discover its falsity should not immunize him from liability.

We'd like to emphasize that the "has reason to know" standard would not penalize individuals involved in a good faith dispute with the Government concerning claims. Rather, it would reach only those who play ostrich with respect to claims and statements submitted to the Federal Government and thereby hope to avoid liability for "knowing" violations.

In an independent study of convicted providers by our office in 1983, we found it to be a common practice for physicians found guilty of fraud by the courts to have attempted to lay blame at their billing clerks or other office help and thereby absolve themselves of responsibility.

Another significant improvement in the bill is a new basis for calculating potential assessment as twice the amount of the claim rather than twice the amount of damages sustained by the United States. The new rule for assessments disposes of the often difficult task of proving specific actual damages to the Government, as well as proving consequential damages, which include investigating and recovering moneys from the wrongdoer. The following case illustrates why damages are so difficult to prove in many cases.

Oftentimes, providers of goods and services to the Government provide something of value, although it is not what the Government desired. Damages are usually the difference between the value between what was provided and what the Government paid for. For example, we have the case of a psychologist who billed for 50-minute individual therapy sessions; however, the psychologist routinely rendered therapy sessions lasting only a fraction of that time and sometimes in a group setting. We have found it impossible to reconstruct an accurate picture of the actual services rendered by the psychologist and therefore, it is not possible to calculate with any degree of precision what the value of the services were that were actually rendered.

We are pleased that the current bill retains the provision authorizing investigating officials to require by subpoena the attendance and testimony of witnesses in the course of the investigations, although there is the added requirement that we first notify the Attorney General. We have no strong objection to notifying the Department of Justice of our intention to exercise this authority. I would simply note that I believe that the ability to compel witness cooperation to obtain evidence during an investigation is a critical tool. Our CMPL statute lacks such authority. We find that most witnesses in our cases are subordinate employees, fearful of their jobs and are in a position to be intimidated against voluntary cooperation.

As explained above, I would strongly endorse many of the new provisions of S. 1134. I would also like to take this opportunity to suggest several important modifications to the bill, again, based upon our experience with CMPL.

First, suggested improvement relates to imposing a penalty for each false line item or service, rather than on the entire claim. Under the current bill, only one penalty up to $10,000 may be levied for each false claim submitted to the United States. Thus, the wrongdoer may merely aggregate the number of false line items into a single claim and thereby minimize their liability.

Instead, we believe that a penalty should be authorized for each such false line item as is currently the rule at HHS. And if the statute were to be amended to impose a penalty for each item or service, we believe that the maximum penalty amount currently at $10,000, could be lowered to something around $5,000.

The second change we would suggest concerns the provision which allows the statute to apply to claims filed only after the effective date of the statute, which would be a full 6 months after the date of enactment. In practical terms, this provision would mean that the first cases brought under the statute would not occur until years hence.

This is unnecessary. We believe that the statute could be applied retroactively in a manner which is completely fair to wrongdoers, by merely limiting their liability to that which exists under the False Claims Act, which has been on the books since 1863. Thus, CMP proceedings would be expressly authorized in any case that could have been brought under the False Claims Act and the wrongdoer's liability would be limited to the liability that he would face under the False Claims Act. We would simply be shifting the proceeding to an administrative forum.

Third, I note that the section of S. 1566 authorizing the United States to set off the amount of any final penalty or assessment against any sum owed by the United States to the person liable for such penalty and assessment, has been dropped from S. 1134. I urge that the provision with respect to setoff be returned to the bill.

Fourth, and finally, we would also like to comment on the subject of procedural rights of the accused wrongdoer. We believe that the provisions contained in the bill afford expedited and simplified procedures for resolving the issues consistent with fundamental fairness. Except for the broad discretion that the bill grants to hearing examiners to order discovery, which we believe is unwise, the rights contained in the bill are similar to CMPL and are those which are required for administrative proceedings by the Administrative Procedures Act.

And in conclusion, Mr. Chairman, let me again emphasize our support for the extension of civil monetary penalties authority to all agencies throughout the Federal Government in a manner modeled on what we feel is our successful experience with CMPL at HHS.

I believe that this legislation, if enacted, would greatly enhance the ability of the United States to remedy, and ultimately to deter, fraud.

Mr. Chairman, let me stand by now to answer any questions that you or the committee might have.

Senator COHEN. Thank you very much, Mr. Kusserow. We want to commend you for an impressive statistical display here.

I was wondering, on page 2 of your statement, you categorize the action taken on 149 cases. The vast majority of those cases, some 76 percent, were settled without a hearing.

How does HHS arrive at a settlement? What leverage do you exercise? How come so many cases were settled and only three actually went to a hearing?

Mr. KUSSEROW. The process that we exercise is that after the investigation has determined the extent of the wrong doing, we confront the accused and his attorney with the facts and suggest what an appropriate settlement might be.

As you can see, in nearly three-quarters of the cases, counsel for the wrongdoer has agreed that that settlement is appropriate. Only about a quarter of them move to take it to an administrative proceeding.

So I think that, in many cases, it's just the fact that they have seen that the wrong doing has been documented and how compelling the case is, and under those circumstances, feel that the appropriate course is to arrive at a settlement.

Senator COHEN. I mentioned before that 3 of the 149 cases went to a hearing. What was different about those three?

Mr. KUSSEROW. In those three instances, the attorney for the defendant felt that they would have a better chance at resolving an equitable settlement by going to an administrative law judge. They chose that as the forum, thinking that that would improve their position.

Senator COHEN. And any results on those?

Mr. KUSSEROW. In all three of the cases that have gone through an administrative due process proceeding, the ALJ's have found for the Government.

Senator COHEN. Same amount?

Mr. KUSSEROW. Same amount in two of the cases. In the third case we requested $2.9 million but were awarded $1.8 million.

Senator COHEN. Of the 18 cases that were retained by the Justice Department—that's about 16 percent of your potential recovery—did the Justice Department normally retain the better or bigger cases?

Mr. KUSSEROW. Yes, those that they feel would warrant prosecution through the U.S. district court. So they do take the larger or the more significant ones.

Senator COHEN. Any progress on those 18?

Mr. KUSSEROW. Once again, as was pointed out by Mr. Willard, one of the handicaps of the Department of Justice is that when they take a case, the proceedings are a lot slower than they would be through the administrative process.

So all 18 of those cases are still within the system. They have not gone to litigation.

Senator COHEN. Senator Levin asked some questions before about "knows or has reason to know." The significance of that standard, according to your statement, is that it reaches those people who would like to play ostrich with the Government.

What has been your experience—you mentioned in your testimony about people, doctors who say, well, it's a billing problem and it's my accountant, it's my secretaries. I didn't have knowledge.

Has that been the prevailing type of situation that you've confronted?

Mr. KUSSEROW. Yes. And as I pointed out in my statement, that we had done an independent study on convicted health providers and practitioners. We found that the most common excuse is to try to lay the blame off on someone else. Basically they say, well, the billing clerk did it. I didn't know it. Or, I'm a doctor; I'm not a businessman. I don't know about such things. I'm a healer.

Or, in many cases, they would say, well, because of the press of duties, I had to sign the claims in advance in blank and they were later filled out by somebody else. And so I just couldn't see what was on there and I just didn't know. Or in many cases, they'll say that there are just mistakes and it was not intentional.

Also in many cases, they say that they have not read the conditions of participation in the Medicaid or Medicare program and they didn't know what was expected of them. In all such instances, they claim that they didn't know specifically that the claims were false.

Senator COHEN. Did you bring any cases against persons who made good faith mistakes or inadvertent mistakes?

Mr. KUSSEROW. No; because the burden we have is to demonstrate, to go actually into the mind of the practitioner and to demonstrate that, through a pattern or practice, through types of instructions that were provided, through how they submitted their claims, the timing of them, how they grouped them, that there was indeed, a concerted effort to obtain money for claims that were unjustified.

Senator COHEN. So you actually go back and try to establish a pattern of behavior, rather than taking one case out of context and saying that this individual had or didn't have knowledge.

Mr. KUSSEROW. We would not be able to stand up to the burden of proving "reason to know," without showing a pattern, without showing circumstances surrounding the claims to indicate that there was wrongdoing on the part of the biller.

Senator COHEN. You also are in favor of testimonial subpoena authority, even though the Justice Department is opposed. I assume the Justice Department is opposed because they don't want the inspectors general to interfere with criminal prosecutions or investigations that might be underway.

On the other hand, you noted in your statement that many times, witnesses are reluctant to come forward without the subpoena, or else they face the loss of their jobs.

Is that basically the problem you've had?

Mr. KUSSEROW. That's been our experience. But I would point out that we do not initiate any proceeding in our Department without permission from the Department of Justice. And that is for all dollar criteria.

Senator COHEN. But you don't have testimonial subpoena power.

Mr. KUSSEROW. We do not have it. But we would not, under any circumstances, proceed with any kind of an administrative subpoena to testimony without first getting permission from the Department of Justice, so that there's no way in which we could interfere with any ongoing criminal investigation. So I could not see how there could be any interference in the process.

I would note that the Department of Justice supports such a subpoena for their own civil fraud prosecutions under the False Claims Act. We think that, for the same reasons, that it would be warranted in the administrative proceedings.

Senator COHEN. Have you been hampered by the lack of testimonial subpoena power?

Mr. KUSSEROW. I would say that we have been hampered. We've been hampered in this respect—that the burden on the investigator is much greater when, in fact, you don't have the ability to compel testimony.

And so you have to conduct a much more detailed investigation and develop circumstantial evidence to overcome the fact that, in many instances, witnesses that are associated with the wrongdoer don't want to voluntarily come forward.

Senator COHEN. A final point before I yield to Senator Levin. You state that you're in favor of the change in the proposed bill that would double the amount falsely claimed rather than impose double damages.

Mr. KUSSEROW. Yes And our experience has shown that people who would submit false claims could game the system. In our Department's programs, we can impose an assessment and penalty for each item claimed. It's very important because the character of the health care programs is often, times the claims can be for a fairly small amount.

For example, with a pharmacy, they may have an average of $5 per claim that's false, where they could take 2000 claims to get up to the $10,000 limit and submit 1 claim; whereas, we think that if a pharmacy were to submit 10,000 false claims, that would be a pretty egregious set of circumstances.

So we think that permitting individuals who would submit false claims to aggregate items into a single claim would thereby subvert the intended purpose of this proposed legislation.

Senator COHEN. One point of clarification. The bill requires double the amount falsely claimed, not double the amount claimed. So there's a very critical distinction, I think, that we will add to in the development of the bill itself.

Senator Levin?

Senator **Levin**. Mr. Chairman, first, on this reason to know issue, has your Agency issued any regulations or directives fleshing out that standard?

Mr. **Kusserow**. Yes, we have, and I'd be happy to submit that for the record, Senator.[1]

Senator **Levin**. That would be helpful. You indicated in your testimony that there's something beyond inadvertence that's required, that there's some wrong doing, a kind of one-word label that you used that you must find either through a pattern or practice or perhaps through the timing or the grouping of the claims, I think you said, or perhaps through the institution of the rules inside the office, the doctor's office, provider's office.

Has this been tested in court in any of your decisions, your particular interpretation?

Mr. **Kusserow**. Not as yet.

Senator **Levin**. Do you use ALJ's for this?

Mr. **Kusserow**. Yes, Senator, we do.

Senator **Levin**. Why do you do that? Is that by law or just by your own——

Mr. **Kusserow**. No. The procedure we set up in our Department was an ALJ system that would operate under the Grants Appeals Board in the Department, outside the Health Care Financing Administration, which administers Medicare and Medicaid. So it's removed from the agency in question and also, of course, removed from the inspector general.

Senator **Levin**. I'm not sure I follow that. Do you do that because of law or by internal decision?

Mr. **Kusserow**. By internal decision.

Senator **Levin**. You decided to have a separate process?

Mr. **Kusserow**. Separate process removed from the agency in question so that we do not have, for example, which was under consideration, to have an ALJ appointed by the Administrator for the Health Care Financing Administration. We felt that that, in discussing the implementation, we thought that would be improper because it would mean that the Administrator would have perhaps an undue influence over the process. So we elevated it to the Grants Appeals Board.

Senator **Levin**. Now in our bill, we don't do that.

Mr. **Kusserow**. You leave some discretion to the agency, which is what we had.

Senator **Levin**. You had discretion?

Mr. **Kusserow**. We had the discretion.

Senator **Levin**. But you exercised it in a certain way because you felt it would be improper not to——

Mr. **Kusserow**. Well, by the nature of our Department, we felt that the best way to go about it was to elevate it outside the Health Care Financing Administration to the Grant Appeals Board with an internal appeal to the Office of the Undersecretary.

Senator **Levin**. Are you in a position to give us advice on other departments relative to this?

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[1] See p. 162.

Mr. KUSSEROW. Well, I think a lot of it depends upon the character of the agencies. Earlier in today's hearing, I note that you queried about the independence of the hearing officer and whether that could be relied upon. For example, in our department, we have adequate evidence of the independence of the Office of Hearings and Appeals in the Social Security Administration, in that they find more for the claimants than they do for the Social Security Administration.

So we felt that the individual character of the agencies and the administrative makeup of the Department would vary from agency to agency.

Senator LEVIN. Did you have some legal advice as to whether to set this up separately the way you did before you reached that decision?

Mr. KUSSEROW. Yes. We had a task force on the implementation of the legislation meet, which included the Office of the General Counsel, as well as consultation with the Department of Justice, to find the best mechanism that would afford an independent and unimpaired due process for any respondents brought through the system.

Senator LEVIN. But would you forward to us whatever portions of that task force report you're able to forward to us which aren't privileged or where there's a privilege waived, or whatever, so that we can have the benefit of your analysis relative to the independence issue?

Mr. KUSSEROW. Yes, Senator, I'd be happy to do that.

Senator LEVIN. It's something that I know we're going to want to spend some time thinking about. We want this to be effective and simple. We don't want to create an elaborate structure. It's an administrative process. It's not a judicial process.

On the other hand, we're also sensitive to the due process issue.

If our bill were adopted and became law, what would that do to your process? Would it supercede it? Do you know?

Mr. KUSSEROW. No, it would complement it very well. We looked at that very closely and it would have no negative effect and they would work side by side very effectively.

Senator LEVIN. So this bill—and I forget the way we drafted it—does not supercede any similar process already in effect?

Mr. KUSSEROW. No, it would complement it.

Senator LEVIN. OK. Is there a limit on the dollar amounts that you claim that you seek administratively?

Mr. KUSSEROW. Well, we operate with an assessment of up to double the claim, and then up to $2,000 penalties for each false claim submitted.

Senator LEVIN. Is there a limit on the amount of the claim?

Mr. KUSSEROW. On the entire amount?

Senator LEVIN. We have a $100,000 limit in this bill. Do you have a limit that you can pursue administratively?

Mr. KUSSEROW. No. Our only limitation is embodied in a memorandum of understanding with the Department of Justice. And the way that works is that in all cases, we refer the case to Justice. We first go with the case to the Criminal Division, which is represented by the U.S. attorney. We present the facts and we do not proceed further until they have made their final determination.

In the civil side, if it's within the discretionary authority of the U.S. attorneys, then they can also make a determination as to whether they wish to proceed civilly or defer to us administratively.

The cut-off there is about $100,000.

Senator **Levin**. Pardon?

Mr. **Kusserow**. The cut-off there is $100,000. Above that amount, authorization to proceed under CMPL must be obtained from the Civil Division in Washington.

Senator **Levin**. Was that cut-off established by——

Mr. **Kusserow**. That's an internal policy of the Department of Justice for what authority that their U.S. attorneys have.

Senator **Levin**. All right.

Mr. **Kusserow**. And then if it's over $100,000, then in addition to going to the U.S. attorney, then we go to main Justice, to the Civil Division, and present it to them. And then they make a determination as to whether they want to proceed civilly.

Senator **Levin**. If it's over $100,000, they could still refer it back to you administratively.

Mr. **Kusserow**. Yes.

Senator **Levin**. OK. So there's no absolute limit of $100,000.

Mr. **Kusserow**. That's correct, Senator.

Senator **Levin**. Now if you make a finding and impose a penalty and assessment—is that the right word under your statute—penalty and assessment?

Mr. **Kusserow**. If we arrive at a settlement——

Senator **Levin**. Well, assuming you impose a penalty and make an assessment—I hope I'm using the right words—in any event, could that lead to a suspension of the provider from your program?

Mr. **Kusserow**. Yes, it could. We call that exclusion from participation in the program.

Senator **Levin**. All right. Now, is that an automatic result of your making a finding or assessing a penalty or imposing——

Mr. **Kusserow**. It is not automatic; it depends on the totality of the circumstance. But it could lead to a period of exclusion.

Senator **Levin**. Putting aside a settlement, when you go to a hearing—does the ALJ make the recommendation on exclusion from the program?

Mr. **Kusserow**. We would make the recommendation to the ALJ and then he would make the final determination.

Senator **Levin**. The ALJ decides whether that person is excluded or not.

Mr. **Kusserow**. No. The exclusion authority is initially with the inspector general. But the respondent may appeal that decision to the ALJ for reduction in time, or for no exclusion at all.

Senator **Levin**. When the ALJ imposes the penalty, does he in that same decision say, you are hereby excluded from the program for 2 years, or 1 year?

Mr. **Kusserow**. Yes.

Senator **Levin**. He does? And that's appealable to whom?

Mr. **Kusserow**. The judicial appeals from the final department decisions go to the Court of Appeals. But, first, they have an intermediate appeal after an adverse ALJ decision, a respondent step, before they go into the court system. That is, can appeal to the Under Secretary.

Senator LEVIN. So this becomes discretionary basically with the ALJ as to whether or not there's an exclusion from the program or not.

Mr. KUSSEROW. They can rule on that, yes.

Senator LEVIN. Is that all set forth in your statute or is that done internally?

Mr. KUSSEROW. By implementing regulations, which clarify the statute. I will submit that for the record.

Senator LEVIN. The relationship between the ALJ's decision on a penalty and on assessments and whether the person would be excluded from the program.

We would like anything you can submit to us on that because we have an issue on that as well.

Senator COHEN. That is not included in this bill. It would have to be a separate proceeding.

Senator LEVIN. I understood that there was—I have to go back and read our bill. I thought we did make the suspension, debarment follow from——

Senator COHEN. No.

Mr. KUSSEROW. Under our statute, we have a peculiar relationship because the providers are participating in our programs and if they do not meet the conditions of participation, we can exclude them. We have several different authorities under which we can exclude them. So it's not really a debarment. And for debarment, you follow a different procedure.

Senator LEVIN. Suspension.

Senator COHEN. One final point. The ABA last year criticized this program fraud bill for being too broad in its coverage, and they specifically contended that we should only apply claims made directly to the Federal Government and not through intermediaries.

Do you have a problem with that?

Mr. KUSSEROW. I would have a problem with their position on that because, for example, in our health care programs, we operate through fiscal intermediaries and carries who act as agents of the U.S. Government for processing claims.

So if their position were reflected in our program, we would, in fact, have no remedy against fraud in the Medicare Program.

Senator COHEN. You mean if the claims went to Blue Cross & Blue Shield?

Mr. KUSSEROW. If Blue Cross & Blue Shield were the fiscal intermediary in an area, then they're acting as an agent for that purpose. It could be Aetna. It could be Prudential. It could be whoever the fiscal intermediary is.

We have no claims presented that don't go through a fiscal intermediary or carrier. So if we didn't have that, by law, then we would have, in fact, made a decision that there could be no remedy for false claims made against the Medicare Program, because all claims are submitted to them.

Senator COHEN. Thank you very much, Mr. Kusserow. You've been very helpful to us here.

Senator **Levin**. Can I just pursue one more question relative to this debarment and suspension argument?

The bill reads—the liability under section 803 of this title may provide the authority with grounds for commencing any administrative or contractual action against such persons.

So the language says that any liability may give the authority the ground to commence. In your process, the same person who makes the assessment and the penalty also decides on the suspension and the debarment.

Mr. **Kusserow**. Yes; you'd follow different rules for a debarment than you would for an exclusion from a program where you're a participant.

Senator **Levin**. What would be your rule on debarment? A separate hearing of some kind?

Mr. **Kusserow**. Yes.

Senator **Levin**. Thank you.

Chairman **Cohen**. Thank you very much, Mr. Kusserow.

[Mr. Kusserow's prepared statement follows:]

PREPARED OF RICHARD P. KUSSEROW

Mr. Chairman and Members of the Committee, I would like to thank you for this opportunity to appear before you and provide comments on the proposed "Program Fraud Civil Penalties Act of 1985." In November 1983, I testified before this Committee in support of a similar bill, and my support continues. Happily, this year, in my capacity as the Chairman of the Legislation Committee of the President's Council on Integrity and Efficiency, I can also provide the Committee with the strong endorsement of civil monetary penalties legislation by the entire Inspector General community. I have, today, a Joint Statement of the views of the statutory Inspectors General. With your permission, Mr. Chairman, I will submit this Joint Statement, together with my own statement, for inclusion in the record.

As you know, since 1981, the Department of Health and Human Services (HHS) has enjoyed statutory authority to levy administrative assessments and penalties against those who file false or otherwise improper claims for payment in the Medicare, Medicaid and Maternal and Child Health programs. This statute has served as a prototype for possible government-wide application. Through the combined efforts of various components of the Department -- the Office of Inspector General, the Office of the General Counsel, the Grant Appeals Board, and the Office of the Under Secretary -- the program to date has proved a resounding success. Further, I fully believe that the

Civil Monetary Penalty program at HHS (hereafter referred to as "CMPL") is fulfilling its dual purpose of enhancing the Department's ability to recover funds lost to fraud, and deterring future fraud.

The most tangible indication of the success of the program is, of course, the money recovered from fraudulent health care providers. In this regard, I am pleased to inform the Committee that in the last 21 months since the implementation of the program, the Department has imposed penalties and assessments, or negotiated settlements totalling in excess of $15 million. The following table itemizes the sources of this $15 million and indicates the stage of the proceedings at which the penalties or settlements were recovered or obligated:

149: Total Cases In Which Action Has Been Taken

18 cases:	Retained by the Department of Justice Estimated potential recovery (not included in total, below)		$ 2,828,232
114 cases:	Settled prior to issuance of a Demand Letter		$12,503,199
16 cases:	Demand Letters issued		
	1 case :	Respondent defaulted	$ 468,524
	5 cases:	Settled after receipt of demand letter and prior to hearing	$ 259,000
	3 cases:	Hearings completed (the U.S. prevailed in all three cases)	$ 1,991,236
	7 cases		Pending
			$15,221,959

In addition, approximately 158 investigations are being reviewed for possible imposition of civil monetary penalties, either through settlement or by issuance of a demand letter.

The above table is noteworthy for several reasons. First, and foremost, it demonstrates the success of the program in dollars and cents. Second, the table illustrates that the vast majority of cases have been settled prior to an administrative hearing, thereby minimizing the drain on the Department's resources. Finally, I would like to point out that the Department has prevailed in the three cases that have been administratively adjudicated. These cases are illustrative of the kinds of fraudulent conduct that may be successfully sanctioned under our civil monetary penalties authority:

- A chiropractor who owned and operated a clinic in Florida, engaged in a large scale scheme to defraud the Medicare program by falsely representing ineligible chiropractic services as reimbursable medical services. In executing this scheme, that spanned several years and involved thousand of claims, the chiropractor billed for unallowable services under the names of physicians who not only never performed the services in question, but were no longer employed by the clinic at the time the services were rendered. On May 15, 1985, an Administrative Law Judge awarded the Department nearly $1.8 million in penalties and assessments against the chiropractor.

- The Department was also awarded $156,136 in penalties and assessments against a Kansas nursing home operator who had included numerous false items in his cost reports. The operator created false invoices to support fictitious entries in his cost reports. For example, he included entries for lawn care services when such services were never sought or provided.

- And, just last week, in a case involving a pharmacist in Louisiana who, in filing prescriptions for Medicaid patients, substituted generic drugs for brand-name pharmaceuticals, the Department was awarded $44,000 in penalties.

Given the success of the CMPL program at HHS, it is not surprising that I am a strong advocate of extension of similar authority to other programs administered by our

Department, and to other agencies throughout the Federal government. For too long, many providers of goods and services to the government have been playing a game of "catch me if you can." I am convinced that this administrative authority is a sorely needed alternative to judicial resolution of fraud against the government. I am equally convinced that such government-wide authority, if aggresively implemented and modeled along the lines of our highly successful prototype, would provide a significant deterrent to those who would defraud the United States.

Following is a brief description of some broad categories of cases that would appear appropriate for administrative resolution. Where specific examples were available to us, they have been included:

- Cases that have been investigated and referred to the Department of Justice for criminal prosecution, but such prosecution was declined, and no civil action was undertaken. For example, an employee of a contractor with NASA was transferred across country to work on a NASA contract. He submitted a receipt for rental expenses -- expenses that would ultimately be borne by NASA under the contract, but in fact, the employee incurred no rental expenses. Prosecution was declined because the employee offered restitution, had no prior criminal record, and the cost to the government to transport witnesses for investigation and hearing would exceed the false claims (totalling $1,626). Under the proposed civil monetary penalties authority, penalties and assessments could be levied.

At the Department of the Interior, a contractor with the Bureau of Indian Affairs submitted inflated billings in connection with services performed under the contract. Total overbillings were approximately $40,000. Criminal and civil action were declined by the Justice Department.

- Cases where the subject is prosecuted and convicted, but civil action by the Department of Justice is not taken: For example, a supplier of durable medical equipment in the state of Washington billed the Medicaid program for a number of items and services that were never provided. The supplier was indicted for 75 counts of Medicaid fraud. However, as part of the plea bargain, the supplier agreed to pay $2,894 in restitution and a nominal fine. Under the proposed civil monetary penalties authority, the government could impose penalties and assessments that would offset the cost of investigation and prosecution.

- Cases where no civil action under the False Claims Act was taken because no monetary injury to the United States could be established: A United States Court of Appeals has held that the Department of Transportation could not recover under the False Claims Act for bid rigging in a Federal highway project in Illinois, because the annual Federal contribution to the highway construction was a fixed sum. Consequently, there was no monetary injury sustained by the United States. Under the proposed civil monetary penalties authority, the Department could nonetheless impose penalties and assessments in these cases.

- Cases where no civil action under the False Claims Act was taken because the dollar loss to the government was difficult or impossible to ascertain: For example, the Department of Commerce has several cases in which contracts or financial assistance were awarded based on documents that contained false statements.

> Where the Department could not establish its decision to award the contract or assistance was directly related to the false statements, it could prove no loss to the government. Under the propose civil monetary penalties authority, the Department could propose penalties of up to $10,000 for material false statements and thereby protect the integrity of the procurement process.

The above summaries of instances in which imposition of civil monetary penalties could appear to be suitable and efficacious is by no means exhaustive. Other examples are included in the Joint Statement of the Inspectors General being submitted for the record. These examples bring home the fact that authority to impose administrative penalties for fraud is not merely a desirable adjunct to criminal and civil court action; in some cases, it would be the *only* effective sanction against entities who defraud the government.

The current bill contains several valuable improvements over its predecessor, S. 1566, which warrant comment. In most cases, these improvements are modeled on the HHS CMPL, certainly a wise approach given the demonstration that our statute *works*, both in achieving the government's objectives and in achieving fundamental fairness for accused wrongdoers. These improvements include: (1) adoption of the "knows or has reason to know" mental element of the offense, (2) adoption of the rule of twice the amount of the claim as an assessment, and (3) authorizing the use of subpoenas to require testimony during the investigation of a case. (This latter point would be new authority).

Foremost among the improvements is the modification of the standard of liability in section 802 to authorize the government to impose penalties and assessments when an individual or entity doing business with the United States submits claims or statements that he knows or has reason to know are false. This standard is identical to that already included in the CMPL pertaining to HHS. We believe this standard is essential to reach conduct by individuals who would avoid finding out what the applicable rules or standards are, and then seek to hide behind their ignorance. For example, if a billing clerk for a clinic blatantly falsifies a claim for reimbursement under Medicare, and the attending physician signs and submits that claim without reading it, the physician could face liability under our CMPL for having reason to know that the claim was false. His failure to read the claim and discover its falsity should not immunize him from liability.

I want to emphasize that the "has reason to know" standard would not penalize individuals involved in a good faith dispute with the government concerning a claim. Rather, it would reach those who "play ostrich" with respect to claims and statements submitted to the Federal government, and thereby hope to avoid liability for "knowing" violations.

Another significant improvement in the bill is the new basis for calculating a potential assessment as twice the amount of the claim rather than twice the amount of damages sustained by the United States. The purpose of the assessment is, of course, to recoup the funds unlawfully taken by the wrongdoer by false claims, and to pay the often substantial cost of detecting, investigating and conducting a hearing with respect to those false claims.

The new rule for assessments disposes of the often difficult task of proving specific actual damages to the government, as well as proving consequential damages, which include investigating and recovering monies from the wrongdoer. These latter costs are particularly difficult to allocate and calculate.

The following cases illustrate why damages are so difficult to prove in many cases. Often times, providers of goods and services to the government provide something of value, although it is not what the government desired.

Damages are usually the difference in value between what was provided and what the government paid for. For example, we have had the case of a psychologist who billed for fifty minute therapy sessions to a variety of patients; however, the psychologist generally rendered therapy sessions of less time, and sometimes in a group setting. We have found it impossible to reconstruct an accurate picture of the actual services rendered by the psychologist, and therefore it is not possible to calculate with any degree of precision what the value of the services actually rendered were.

Similarly, several companies have been prosecuted for improperly testing silicon chips purchased by the government and installed in military and space equipment of all types, including computers, missiles, planes, tanks, etc. When one of these items fails, it can cause destruction of an entire weapon, as well as constitute a safety hazard to the personnel operating the weapon. In such cases it is impossible to determine that it was the faulty chip which caused the malfunction, and it is therefore not possible to calculate with any degree of precision what the damages to the government really are.

In cases involving small dollar amounts, which is one of the primary objects of this bill, insisting on proof of damages for an assessment may yield inappropriately small dollar figures. For example, we find pharmacists who have substituted generic drugs for brand name prescriptions. The damages in any one instance of such conduct are only two or three dollars, but to prove the falsity of a prescription claim, an investigator must visit a beneficiary's home and if the beneficiary still has the medication, determine whether it is generic or brand name. An assessment of damages, or even twice damages in such cases, yields an absurdly low assessment relative to the cost of investigation.

In administering the CMPL, we have not taken advantage wrongdoers by seeking assessments for amounts grossly in excess of actual damages. More often, where actual damage figures can be readily obtained, we seek an assessment of twice those damages. We administer this provision responsibly, and we can see no reason to assume that other agencies would behave otherwise.

If any change is to be made in this provision, we would suggest adopting the rule of twice the amount claimed in any item or service which contains the falsehood. In other words, the agency would be limited to demanding twice the amount claimed with respect to any individual item or service within a claim form which contains falsehood. This would largely eliminate the specter of a million dollar claim with a ten thousand dollar false item, and the wrongdoer being liable for an assessment of $2 million dollars. If our suggested change were made, the wrongdoer would be liable for only twice the amount of that part of the claim which contained the ten thousand dollar falsehood.

We also note that the current bill has retained the provision authorizing investigating officials to require by subpoena the attendance and testimony of witnesses in the course of investigations, although there is an added requirement that we first notify the Attorney General. I have no strong objection to notifying the Department of Justice of our intention to exercise this authority. I would simply note that I believe that the ability to use compulsory process to obtain evidence during an investigation is a critical tool. Our CMPL statute lacks such authority.

As explained above, I strongly endorse many of the new provisions of S. 1134. I would also like to take this opportunity to suggest three important modifications to the bill, again, based on our experience with the CMPL. They are (1) imposition of one penalty amount for each false item or service on a claim form, rather than one penalty per claim, coupled with a reduction of the penalty amount, (2) authorizing retroactive effect of the statute limited to the liability a wrongdoer would have had under the False Claims Act; and (3) a provision authorizing set-off of the penalty and assessment against other monies due and owing from the government.

The first suggested improvement relates to imposing a penalty for each false item or service, rather than on the entire claim. The problem here is that wrongdoers will have a powerful incentive to combine false line items, since there can only be one penalty amount for an entire claim form. In the health care area, many claim forms -- such as cost reports - can contain a myriad of false line items. It doesn't make sense to impose a single $10,000 penalty in such a case, whereas a wrongdoer that submits many false claims may justifiably face much higher penalties. If the statute is focused on a penalty for each false item or service, the penalty is more closely targeted to the number of falsifications.

This improvement has an additional advantage. Some may say that it is unfair to expose a wrongdoer to an assessment of up to twice the entire amount of the claim of say, $1,000,000, when the claim may contain only a single false item of $10,000. Making the assessment of up to twice the amount claimed only for the amount claimed for the falsified item or service would eliminate this issue. This policy, in fact, is how we have been administering the CMPL. If a health care provider falsified 10 line items in a 50 item claim, he is liable for a penalty of 10 times $2,000 ($20,000), plus an assessment of up to twice the amount claimed for those ten items only.

Incidently, in the sixteen lawsuits we have initiated under CMPL, we have yet to demand the absolute maximum amount which we could have demanded. The amount demanded has always been tempered by reasonableness, and we believe that it could be expected that other agencies would administer a civil monetary penalty authority in this fashion.

If the statute were to be amended to impose a penalty on each item or service, we believe that the maximum penalty amount, currently $10,000, could be lowered to $5,000. We would not suggest lowering the amount to he $2,000 level as under CMPL, because the amounts of money claimed on a _per item or service_ basis under the programs of other agencies - such as the Defense Department -- are much larger than the items or services claimed under Medicare and Medicaid.

The second major change we would suggest concerns the provision which allows the statute to apply to claims filed only after the effective date of the statute, which would be a full six months after the date of enactment. In practical terms, this provision would mean that the first cases brought under the statute would not occur until years hence.

This is unnecessary. We believe that the statute could be applied retroactively in a manner which is _completely_ fair to wrongdoers, that is, to limit the retroactive effect of the statute to the liability a wrongdoer faces now under the False Claims Act, which has been in the books since 1863. This legal approach has been approved of by the Supreme Court and by several courts of appeal. If substantive liability is not increased, then Congress may prescribe a different forum and set of procedures to determine and vindicate the government's interests with respect to that liability. (See, Hallowell v. Commons, 239 U.S. 506 (1916); Crane v. Strickland, 151 F.2d 419 (5th Cir. 1945); Montana Power Company v. F.P.C., 445 F.2d 739 (D.C. Cir. 1970) (en banc, cert denied 460 U.S. 1013).

Third, I note that the section of S. 1566 authorizing the United States to set-off the amount of any final penalty or assessment against any sum owed by the United States to the person liable for such penalty and assessment, has been dropped from S. 1134. This right to set-off would often guarantee the "collectibility" of assessments and penalties levied under the statute and thereby preserve one goal of the legislation -- to recompense the government for funds lost to fraud. Set-off provisions would also avert extensive litigation to collect the sums owed by persons found liable under the Act. Most importantly, I believe that the express inclusion of the Government's right to set-off will alert those who might defraud the government that any funds owed them by the United States would be at risk, and therefore, act as a deterrent. Therefore, I urge that the provisions with respect to set-off be returned to the bill.

Finally, we would also like to comment on the subject of procedural rights of the accused wrongdoer. We believe that the provisions contained in the bill afford expedited and simplified procedures for resolving the issues, consistent with fundamental fairness. The rights contained in the bill are similar to CMPL and are those which are required for administrative proceedings by the Administrative Procedure Act. That Act purposely designed administrative forums in which controversies could be resolved more quickly and more simply than court proceedings. Under Section 803, the alleged wrongdoer is entitled to written notice of the allegations and applicable procedures, reasonable discovery rights and an opportunity to be heard before an impartial hearing examiner. At the hearing, he is entitled to be present, to be represented by counsel, and to present evidence on his behalf. There are explicit protections against ex parte contacts. The accused wrongdoer is also entitled to a written decision based upon the record, and to an appeal to the agency head, and also to judicial review. We can see no reason to believe that the courts of appeal will countenance any abuse of the constitutional rights of the alleged wrongdoer, or abuse of the procedures afforded by this proposed legislation.

In conclusion, let me again emphasize my support for extension of civil monetary penalties authority to all agencies throughout the Federal government in a manner modeled on our successful experience with the CMPL. Based on our experience at the Department of Health and Human Services, I believe that this legislation, if enacted, would greatly enhance the ability of the United States to remedy and ultimately to deter, fraud. I am, of course, ready to provide any assistance I can to your Committee in its efforts to craft a strong, effective and fair bill that will meet with approval and prompt passage.

I note that the views expressed in this testimony are my own, and do not necessarily accord with those of the Administration.

Senator COHEN. Joseph Sherick, the inspector general of the Department of Defense, was scheduled to testify this morning, but due to an illness, he cannot be with us. Testifying on his behalf is Derek Vander Schaaf, the deputy inspector general.

I might also point out that Mr. Sherick and his staff have been very generous in providing advice to this subcommittee in drafting the program fraud legislation.

Mr. Vander Schaaf, we look foward to hearing from you this morning.

TESTIMONY OF DEREK J. VANDER SCHAAF, DEPUTY INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Mr. VANDER SCHAAF. Thank you, Mr. Chairman. It's a privilege to be here again. Mr. Sherick sends along his regrets. I know he wanted to be here very much. He has testified on this, or very similar legislation on two previous occasions. Our office continues to support your efforts to establish an administrative penalty mechanism to address false claims and false statements.

The Secretary of Defense has supported the development and aggressive use of civil administrative and contractual remedies for fraud in conjunction with, or in lieu of, criminal prosecution.

Traditionally, criminal prosecution has been treated as the primary weapon against fraud, and in many instances, as a precursor to any other action. This has sometimes led to the practice that when prosecution was declined, there was no subsequent attempt to seek administrative action to punish offenders, protect the Government, and recover funds lost through fraud. This practice seemed to favor a one-shot remedy, the criminal case, at the expense of any other related efforts.

Now we in the DOD have, through a number of efforts, attempted to stop this practice and improve the way we address fraud in a coordinated approach to the investigation of fraud and the timely imposition of appropriate remedies for fraud. We have taken several decisive steps in this area which are spelled out in my formal statement. However, I want to tell you that despite these efforts, we have clearly shown that additional remedies are needed, which is why the Program Fraud Civil Penalties Act is so important to us in the IG business.

The act offers a mechanism for appropriate Government response to instances of fraud that occur, but are not now addressed for a variety of reasons. Many of the cases referred to the Department of Justice by DOD are declined for prosecution. Many of these cases clearly involved fraud. However, there are reasons for not prosecuting these cases. The primary reason, as has been mentioned here this morning, is generally the relatively small dollar amounts involved. Other reasons include the evidentiary standard required to prove criminal violations, as well as the priorities within the Department of Justice and its ability to devote resources to the problem.

Now in making these resource allocation determinations, one criteria which is used is the dollar value of the loss to the Government. Therefore, some U.S. attorneys have established thresholds, below which, absent special circumstances, fraud cases will generally not be accepted for prosecution.

While the Department of Justice is clearly responsible for such prosecution decisions, the integrity of DOD programs must ultimately be the responsibility of the Department of Defense.

Accordingly, I believe it is necessary to have a procedure within the Department of Defense to appropriately address those instances of fraud which the Department of Justice does not prosecute, but which clearly impact upon the integrity of our programs.

Now my prepared statement includes several examples illustrating the need for a civil penalty mechanism, particularly in the procurement fraud area, which is of primary interest to the DOD IG. An administrative penalty mechanism could have been utilized in the examples that I have in my statement. I won't go over those examples, Mr. Chairman, but if you or any member of the staff needs more information on them, we would be happy to provide it.

There are a number of reasons, important reasons, why we think S. 1134 ought to be adopted. First, the bill includes false statements, as well as false claims. This is important in the contract fraud area, especially when a contractor can falsely make a variety of certifications. My statement lists some of those certifications that from time to time are falsely made.

These certifications are usually accepted at face value and are rarely questioned because much of the Federal contracting process relies upon the integrity of the DOD contractor to accurately provide this information. When a false certification is discovered, it undermines this essential relationship.

These cases are rarely prosecuted, and unlike false claims, there is no civil statutory remedy for false statements. This bill will close that existing loophole and allow DOD to penalize contractors who undermine the integrity of the contracting process.

Second, I believe the knowledge standard provided for, which has been addressed here this morning at length, "knows or has reason to know," is an appropriate one for a finding of liability under the act. I favor this general intent provision over a requirement to establish specific intent to defraud in order to make a finding of liability. This general intent standard has general acceptability in civil cases litigated under the False Claims Act and in administrative matters.

The act also provides that a finding of probable cause or liability under the act may provide grounds for commencing other agency administrative or contractual actions related to fraud, but does not require such actions to be commenced. A finding of fraud under the act will not automatically result in a final decision on any matters, such as suspension or debarment, because the suspension and debarment authority must consider other relevant factors which bear upon a contractor's responsibility.

The provisions of the act dealing with notice, hearings, and determinations of liability will serve to protect the right to a fair and reasonable hearing for any person alleged to be liable and provide adequate due process for all parties concerned.

I recommend, however, that specific provisions be included in the act to allow the Government to collect assessed penalties by the use of offset rights. The act should specifically allow the Federal

Government to offset from existing government liabilities any amount for which an individual has been found liable under the act. This will enable the Government to collect such damages in an expeditious manner. Since this bill provides adequate due process in determining liability, the act should not require the Government to duplicate these procedures in collecting through offset. For this reason, the act should specifically exempt collection from the requirements of the Debt Collection Act.

This, I might add, is a particular problem right now since there's been a decision by the Board of Contract Appeals which applies the Debt Collection Act to contract offsets. I believe the Government is appealing that case, but until that is cleared up, we recommend that you add such a provision to this bill.

In conclusion, I believe that this bill will provide an important weapon to the Department of Defense, as similar provisions have already been of great assistance to the Department of Health and Human Services in their campaign against fraud. It is ironic that HHS has had this authority to combat fraud in health programs. but the Department of Defense has not had this authority to deal with fraud in defense contracts.

Mr. Chairman, that completes my statement. I will attempt to address your questions.

Senator COHEN. Thank you very much, Mr. Vander Schaaf. Just a couple of questions. I'm going to read to you the Aerospace Industries Association's testimony that they submitted to the subcommittee.

"We're deeply concerned that, in light of the extraordinary complexity of procurement regulations, the innocent or negligent omission of a material fact may subject a contractor to a substantial liability under the bill."

What is your reaction to that statement? Is there any basis for it?

Mr. VANDER SCHAAF. I don't know the basis for that statement. I certainly see no basis in this bill for that statement.

Right in the law, you say a couple of times that a statement has to be material and you have to find knowledge and all the other ramifications which involve finding evidence of fraud in order to move against such matters.

Senator COHEN. Yes.

Mr. VANDER SCHAAF. I just fail to see how we're going to prosecute anybody's mistakes. We never have in the past and there isn't any basis to do so under this legislation.

Senator COHEN. You drew the distinction in your testimony between general intent and specific intent. You heard the prior witness, Mr. Kusserow, testify about how they try to establish a pattern to prove general intent.

Would you expect to try to do the same thing so as not to penalize good faith, innocent error or innocent omissions? Would you try to establish patterns, instructions, billing practices, and so forth?

How would you go about doing that?

Mr. VANDER SCHAAF. Yes, Mr. Chairman. In fact, we do that all the time in our business. In the area of defective pricing, for example, we try to find a pattern in all the contracts that a particular firm might have with the Department of Defense. We look to see if we can find a pattern of charges or costs presented in his proposals which exceed costs or proposals that were, in turn, presented by lower tiers to him.

Obviously, finding one mistake is not enough. We also look for a pattern of mischarging in timecards. Obviously, an employee can make a mistake, or a number of employees could make mistakes on their timecards. But if the same thing shows up again and again, we can use the pattern to prove the intent.

Senator COHEN. Has it been your experience with contractors that you find yourself in dispute with point to the complexity of the procurement regulations as the reason for the omission, error, or challenged aspect of the claim?

Mr. VANDER SCHAAF. I think this happens from time to time. I haven't seen this to be a big problem. I guess it happens a lot with small businesses, the smaller contractors. These regulations are awesome. I mean, they're very tough to deal with for any small firm. They're tough for us in the Government who work with them day in and day out to understand and work with.

Senator COHEN. Are they less tough for a bigger firm?

Mr. VANDER SCHAAF. I think so. A bigger firm works with them regularly.

Senator COHEN. You're a pretty big firm.

Mr. VANDER SCHAAF. We're a big firm. But we still have a difficult time dealing with them, believe me.

Senator COHEN. Mr. Dawson, who's going to be testifying shortly, expresses the concern that this bill appears to allow the Government at its option to avoid going to the Federal courts by splitting, by way of example, a $2 million alleged fraudulent scheme and then holding 20 or more separate administrative proceedings.

Is it possible, let alone probable, that this could take place under this bill?

Mr. VANDER SCHAAF. It certainly is not probable. I would assume that we would write administrative procedures to make that impossible. Theoretically, I guess we could have a situation where we had a major false claim—an amount substantially above $100,000. We would attempt to get the Justice Department to take action on it.

They could start that process and not complete it, for one reason or the other. We would then find a single piece of that claim where we could use a lesser rule of evidence. By using the administrative procedure outlined in your bill, we could at least recover some of the Government's loss.

Senator COHEN. But the Justice Department, in effect, holds a veto over this entire measure by either approving or disapproving the agency's program of broad proceedings if they should choose to do so.

Mr. VANDER SCHAAF. That's an obvious protection right there. We would refer all of the cases to Justice for a determination. If we didn't get a determination, this law allows us to move on our own at that time. In most cases, we would receive such a determination from the Justice Department. If they decided to accept the case, we would leave it and that would be the end of it. If they determine that they do not want to proceed with the case and we believe there is a valid case there, we would then start the hearing process.

Senator COHEN. The ABA has recommended a solution to this particular problem by saying that the $100,000 jurisdictional cap should apply to any claim or group of related claims.

Would you agree with the ABA's recommendation or would that encourage contractors to combine claims in order to exceed the cap?

Mr. VANDER SCHAAF. I don't think we really have a position on this, Mr. Chairman. We would like to see this legislation passed, and I think that's a fine point that we can argue about. Maybe in the medical business it's nice to have each and every line item on a particular invoice or on a DD-250 subject to a separate action. However, either way it's written, I think we in the Department of Defense, at least in the Office of Inspector General, would be satisfied with the provision as it's in your bill right now, or as Inspector General Kusserow proposed.

Either would be acceptable to us.

Senator COHEN. Just another final point. False statements versus false claims. Again, the ABA is going to testify in a moment that in the case of false statements, the Government suffers no damage and therefore has no need or grounds for relief.

Mr. VANDER SCHAAF. I would disagree with that. The Government does suffer damage. The Government does not necessarily suffer direct monetary damage. But false statements certainly affect the integrity of our programs.

I'm talking about everything from employment applications to small business certifications to certifications of testing or product performance, minority business certifications, all of which can lead us to make bad decisions. For example, we hire the wrong person who's not qualified because someone submitted a false statement, or we give the contract to a large business who makes a false certification that they are a small business. We can't prove monetary damage, but we certainly have some damage to our program and the integrity of the whole process.

Senator COHEN. Would a finding under this bill automatically trigger a suspension or debarment?

Mr. VANDER SCHAAF. Absolutely not. This is, again, a misconception. Secretary Taft wrote a policy last August, I believe it was August of last year, which essentially said, if you're a convicted felon, you're going to have a hard time proving current responsibility. The policy dictated that there would be a 1-year debarment following a felony conviction, unless special circumstances dictated otherwise. Since the implementation of Secretary Taft's directive, in four different cases, we've already found special circumstances which dictated otherwise. Otis Elevator pleaded guilty to a cost mischarging case, I believe at the Department of Transportation. We in DOD did not debar Otis Elevator. Smith Kline, a drug firm, pleaded guilty to false statements on a Food and Drug Administration case. The Department of Defense continues to do business with Smith Kline.

Alpha Industries—I don't know if it was a guilty plea or was found guilty on the antikickback act in a relationship with Raytheon Corp. We have not debarred Alpha Industries. Another firm called UCO Electronics, a subcontractor to the IBM Corp., was convicted of mail fraud, and we have not debarred them.

I think this is a red herring, Mr. Chairman. We will not suspend and debar automatically based upon this administrative procedure. The facts that we uncover during the administrative process, and your bill properly does this, can be used in the suspension and debarment process, rather than to force the Government to again prove the entire factual situation and start the process all over again. But there will be a separate hearing to determine whether debarment ought to follow.

Senator COHEN. I assume you looked at factors such as what action, disciplinary action, has been taken by the contractor, what the general reputation is—all of which should be taken into account in assessing whether a debarment or suspension should be invoked.

Mr. VANDER SCHAAF. Absolutely.

Senator COHEN. Senator Levin and I have been concerned about suspension and debarment, I think since 1979, when we first started holding hearings. We were perhaps two of the most vocal critics that there seemed to be no uniformity of suspension and debarment proceedings. Someone debarred from one agency could walk right across the street and start doing business all over again.

So we have been very much involved in debarment and suspension proceedings.

Mr. VANDER SCHAAF. We've taken a number of steps in the past 2 or 3 years to tighten up on that process, Governmentwide, and then within the Department of Defense. The numbers of suspension and debarments reflect this tightening up.

Senator LEVIN. I was just trying to recollect my corporate memory with my staff about debarment and suspension because we have worried for many years about the lack of debarment and suspension actions where they would be appropriate. We worked to resolve the situation where one agency debarred a person and then another agency didn't even know about the first agency's debarment and continued to do business with the debarred individual.

So we have, indeed, been involved in this for a long time. I would think that there should be a presumption that if someone is found guilty of violating the False Claims Act, that debarment and suspension should follow.

Now maybe that's too strong. But I think, clearly, if it's through a court proceeding, that there ought to be a presumption. Maybe even an administrative——

Mr. VANDER SCHAAF. The presumption——

Senator LEVIN. Not rebuttable. I'm not saying that there aren't circumstances where you don't want to debar and suspend. I just think it ought to count for something. What it should count for may be debatable, whether it ought to be evidence in the debarment and suspension hearings or whether it ought to provide some presumption of some kind.

I just don't know. But it ought to count for something in a debarment and suspension proceeding, whether it's administrative or judicial, I would think. We will look into that language in this bill as to exactly what it does count for. You said in your testimony just a moment ago, it can be used.

Mr. VANDER SCHAAF. Absolutely.

Senator LEVIN. Well, how it can be used, of course, is critical, but I think it should be usable in some way. I would agree with that. It shouldn't be automatic, perhaps, but it should be usable.

Now back to the standard—first of all, let me compliment you on the number of examples that you've given us where you have been unable to recover money because the amounts were too small and the Justice Department decided not to prosecute or pursue the claim purely because of its size.

You've given those examples on pages 3 through 6 of your prepared testimony. If anybody has any doubt as to the need for this kind of a bill, I would suggest that they read your testimony, pages 3 through 6. The chairman has once again put his finger on a very critical need in this Government in introducing this legislation and I commend him for it. The examples that you give on those pages are eloquent testimony that we now give up going after $25,000 or $50,000 or $100,000, that we've been cheated out of purely because it's "only" $25,000 or $50,000 or $100,000.

Not only do we lose that, but there's no deterrence. We lose a lot more because people think—they know—they can get away with small amounts of fudge.

Senator COHEN. Those small amounts, I believe, total up to about $1 billion.

Mr. VANDER SCHAAF. Well, there's a lot of dollars. I don't think anyone knows what they total up to, Mr. Chairman.

Senator LEVIN. The total is tremendous.

Mr. VANDER SCHAAF. The prevention potential from this bill, not only to just contractors—we seem to focus on contractors—but on the government employees who file fraudulent travel claims or who receive benefits from the CHAMPUS Program, from the PX or commissary programs or from our other health programs; there are tremendous possibilities here that we will see a great decline in such actions; people will start thinking twice before they make false statements of eligibility for these programs.

Senator LEVIN. I think there's agreement from your testimony that we do not want to go after the innocent error. We do want to go after something more serious than that. And exactly where we draw the line I think is open to debate.

You used the word, I believe, "negligent" as an area where we would not go. I may be wrong. I thought you used the word "negligent."

Mr. VANDER SCHAAF. If I did, I didn't intend to. Certainly, we would go under the "knows or has reason to know." If we find someone who is grossly negligent—as somebody said up here earlier, you can't bury your head in the sand and not look at any of the bills that you're submitting to the Government and say one of my underlings did this. You obviously have some responsibility when dealing with the Government to look over the paperwork you submit to the Government.

Now, if I'm not mistaken——

Senator LEVIN. If we divide that test into three, and I think there may be even more gradations than three, but if we divide the reason to know test into negligence, gross negligence, reckless disregard, you would cut the line at gross negligence?

Mr. VANDER SCHAAF. That's right.

Senator LEVIN. In implementing this, would you use lawyers as your hearing officers or ALJ's? I know the Defense Department doesn't have ALJ's, but would you seek to implement some system, you think, with ALJ's or similar hearing officers?

Mr. VANDER SCHAAF. I think that we would probably not use ALJ's. Historically, the Defense Department has not used ALJ's, although some hearing examiners may be as qualified as ALJ's. I don't know. I would have to take that matter up with the General Counsel of the Department, who would decide what type of hearing examiner would be used and would have to develop the administrative procedures to implement the act in DOD.

Senator LEVIN. There hasn't been any discussion in the Defense Department about implementing this yet?

Mr. VANDER SCHAAF. No. We've been kind of cheering it on for the past two Congresses, but each time, we don't quite cross the goal line. Maybe we'll make it this year.

Senator LEVIN. Well, I hope so. It's important that we not only cross the goal line but we must cross it just as accurately and sensitively to all the needs as we possibly can. And whatever guidance you might have on implementation would be useful.

If there is any guidance before we vote on this as to how you would implement it, and many of the issues that we've talked about, do forward it to us, because I think these are critical issues for us: Do we want to require lawyers? What is the standard in terms of should know or should have known or failure to know? Should we permit discovery? These and the other questions which have been raised are important, and to the extent that we propose to include them in law, we would like your guidance.

Mr. VANDER SCHAAF. Senator, I know my staff has been working with the committee staff on some of this. There's one other point I should personally make since the Justice Department witness, Mr. Willard, indicated that he was not in favor of providing the IG's with testimonial subpoena authority.

I want to tell you that I think not to provide that would be very much a mistake because it's the same people who don't want this legislation and who say that you're going to prosecute mistakes with this kind of legislation, not knowing if there is true intent of fraudulent activity, who don't want to give us this testimonial authority.

Well, the way we can prove intent and eliminate honest mistakes is to get testimony from people and individuals. That becomes the key factor. We can lay out a whole pattern on paper in many cases and we can say quite clearly that this paperwork isn't right. Something is wrong with it. You can lay this out in considerable detail. But it really helps if you've got an individual who can say, yes, the paperwork is wrong and people knew it was wrong when they submitted it to the Government. That is important and anything we can get in terms of demanding or requiring testimony would be helpful.

Senator LEVIN. My last question is: Has there been any discussion in your shop about dividing the prosecutorial role from the quasi-judical role and the appellate role, separate them to be certain if we decide it's desirable to, that the appointing authority for the hearing officer is somehow dependent or separated from the appointing authority for the prosecutorial personnel?

Mr. **Vander Schaaf**. I don't believe that question has been discussed in any detail. It may have been. I don't know. I have someone here in the audience, Mr. Cox, who might want to say something on that.

However, we could work that out, I think, quite easily in the Department of Defense, as diversified as we are. With the Secretary of Defense serving as the authority in this case and putting hearing examiners in the military departments ought to insulate those hearing examiners quite well from abuse by the convening authority.

Senator **Levin**. Thank you, Mr. Chairman.

Senator **Cohen**. Thank you very much, Mr. Vander Schaaf.

Mr. **Vander Schaaf**. Thank you.

[Mr. Vander Schaaf's prepared statement follows:]

PREPARED STATEMENT OF DEREK J VANDER SCHAAF

I would like to thank you for this opportunity to appear and provide my comments on an important legislative matter, the proposed Program Fraud Civil Penalties Act, S. 1134. This legislation will permit the Inspectors General to more effectively combat fraud, waste and abuse, and further implement the Administrations's initiatives in this area.

The Office of the Inspector General for the Department of Defense, continues to support, as we have in the past two Congresses, the establishment of an administrative penalty mechanism to address false claims and false statements submitted to the Department of Defense. The Secretary of Defense has supported the development and aggressive use of civil, administrative and contractual remedies for fraud in conjunction with or in lieu of criminal prosecution. Traditionally, criminal prosecution has been treated as the primary weapon against fraud, and in many instances, as a precursor to any other action to be taken. This has sometimes led to the practice that when prosecution was declined, there was no subsequent attempt to seek administrative action to punish offenders, protect the Government and recover funds lost through fraud. This practice seemed to favor a one shot remedy, the criminal case, at the expense of any other related efforts.

We in the DoD have, through a number of efforts, attempted to stop this practice, and improve the way we address fraud in our programs. Our efforts have been directed at achieving a coordinated approach to the investigation of fraud and the timely imposition of appropriate remedies for fraud available to us. We have taken several decisive steps in this area:

o We have prepared a DoD Directive requiring the establishment of a single authority in each Military Department and Defense Agency to monitor fraud investigations and to coordinate criminal, civil, administrative and contractual remedies for fraud.

- We have encouraged simultaneous civil and criminal referrals of fraud cases to the Department of Justice.

- We have designed and presented a fraud training program for auditors, investigators and attorneys. This program familiarizes the participants with DoD contracting procedures, fraud investigative techniques, and relationships with the Department of Justice. Further, the program describes and stressess the need for coordinated application of administrative, civil, contractual, and criminal remedies for fraud. We have now presented this program 16 times with over 650 attendees.

- Increased efforts have been made in providing fraud awareness training to program officials, particularly personnel assigned to procurement responsibilities. During the last two years, my office and the military criminal investigative organizations have made approximately 6,800 fraud awareness presentations to over 255,000 attendees worldwide. These briefings stress improved recognition of potential fraud and more effective use of available remedies.

Each of these efforts has yielded improvement in the use of existing remedies for fraud. They have also clearly shown us that additional remedies are needed, which is why the Program Fraud Civil Penalties Act is so important. The Act offers a mechanism for an appropriate Government response to instances of fraud that occur but are not now addressed by the Government for a variety of reasons.

Many of the cases referred to the Department of Justice by DoD are declined for prosecution. Many of these cases clearly involve fraud. However, there are many reasons for not prosecuting these cases, including the evidentiary standard required to prove criminal violations, as well as other priorities to which the Department of Justice must devote its resources.

In making these resource allocation determinations, one criteria which is used is the dollar value of the loss to the Government in the case. Therefore, some United States Attorneys have established thresholds below which, absent special circumstances, fraud cases will generally not be accepted for prosecution. While the Department of Justice is clearly responsible for such prosecution decisions, the integrity of DoD programs must ultimately be the responsibility of the Department of Defense. Accordingly, I believe it is necessary to have a procedure within the Department of Defense to appropriately address those instances of fraud which the Department of Justice does not prosecute, but which clearly impact upon the integrity of our programs.

There are several examples illustrating the need for a civil penalty authority, particularly in the procurement fraud area, which is the primary area of interest for my office. An administrative penalty mechanism could have been utilized in the following closed cases:

- Based on a GAO report, a Department of Justice and Naval Investigative Service investigation identified over $600,000 in fraudulent overpayments on a base maintenance contract in the Norfolk, Virginia, area. The contractor was found to have deliberately overbilled the Navy on numerous items. Because of evidentiary problems, a decision was made to seek criminal prosecution on only $25,000 in false claims. Subsequently, the Department of Justice determined that $25,000 was too small an amount to justify prosecution, and the case was declined for both criminal and civil action. An administrative penalty in this case could have facilitated a recovery of a substantial loss.

- A contractor engaged in a conspiracy with a DoD contracting officer in order to be awarded a DoD contract. The contracting officer falsified the need for a sole source procurement and, in collusion with the contractor, allowed the contractor to write the Government's sole source justification for the award. While prosecution was declined, in part because DoD discovered the scheme before the actual award of the contract and before there was a dollar loss to the Government, a conspiracy to defraud was clearly evident. Again, an administrative penalty would have been appropriate to punish this attack on the integrity of the procurement process.

- A medical supply company, in concert with a military doctor who was a part owner in the company, arranged to have a medical device purchased from the company on a sole source basis. Using his position as a senior medical advisor, the military doctor succeeded in recommending that this product be purchased DoD-wide on a sole source basis. The device was ultimately determined to be defective by the Food and Drug Administration, and possibly dangerous to use. It was withdrawn from DoD supply channels. The military doctor was convicted of related charges in Federal court and administratively reduced in rank at retirement. No criminal action was taken against the company or its officials. An administrative penalty against the company would have been appropriate in view of its collusion to defraud DoD.

- A painting contractor was required to use enamel and oil based paints and apply them with rollers and brushes to portions of structures exposed to the elements on a military installation. A quality assurance inspector caught the contractor applying latex water base paint with a sprayer. The contractor was stopped from performing the balance of the work, thereby limiting the amount of monetary loss to the Government. The Department of Justice declined prosecution of the case since we stopped the contractor early and prevented an extensive loss which would have given the case greater prosecutive merit. An administrative penalty would clearly have been appropriate here.

- A contractor was to erect and paint fences on a military installation. The contractor was discovered using Government equipment and property to do part of the work and then failing to comply with contract specifications in the rest of the work. The Department of Justice declined prosection in favor of administrative and contractual remedies, which could have included an administrative penalty hearing, had the Act been in effect at the time.

- In the CHAMPUS area, we have identified numerous cases where both claimants and medical service providers have submitted false claims and statements for treatments which were never provided, or for fraudulent overtreatment. In those cases where we have obtained prosecutions, our efforts to recover the funds have been successful. However, many CHAMPUS fraud cases are not prosecuted because, even though fraud has been proven, the loss to the Government is under $5,000 and criminal prosection in such cases is declined in favor of higher dollar cases. Given the fact that CHAMPUS is a program exceeding $1 billion annually with a substantial vulnerability to fraud, the imposition of an administrative penalty in such cases is a valuable tool to ensure recoveries of losses due to fraud.

o A contractor operated a parts store on 10 different military bases. He illegally inflated parts prices on each contract. While the total fraud amounted to over $50,000, no single base was defrauded for more than $6,000. Each case was presented to nine separate United States Attorneys, and was declined at each office because the dollar value was too low.

There are a number of particularly important aspects to S. 1134 on which I would like to comment. First, the bill includes false statements as well as false claims. This is important in the contract fraud area, especially when a contractor falsely makes a variety of certifications, such as:

- a certification of small business size status;
- a certification of minority status;
- a certification regarding allowability of overhead costs;
- a certification regarding the completeness and accuracy of cost and pricing data.

These certificates are usually accepted at face value and are rarely questioned because much of the Federal contracting process relies upon the integrity of DoD contractors to accurately provide such information. When a false certification is discovered it undermines this essential relationship. These cases are rarely prosecuted, and unlike false claims, there is no civil statutory remedy for false statements. This bill will close this existing loophole, and allow DoD to penalize contractors who undermine the integrity of the contracting process.

Secondly, I believe the knowledge standard provided for -- "knows or has reason to know"-- is an appropriate one for a finding of liability under the Act. I favor this "general intent" provision over a requirement to establish specific intent to defraud in order to make a finding of liability. This general intent standard has general acceptability in civil cases litigated under the False Claims Act and in administrative matters.

The Act also provides that a finding of probable cause, or liability, under the Act may provide grounds for commencing other agency administrative or contractual actions related to fraud, but does not require such actions to be commenced. This will enable the Government to commence such actions without the need to conduct another fact finding proceeding to establish the facts supporting the fraud. A finding of fraud under the Act will not automatically result in a final decision on any other matters such as suspension or debarment, because the suspension and debarment authority must consider other relevant factors which bear upon a contractor's responsibility, (e.g. corrective actions taken by a contractor, efforts to rectify the results of the fraud).

The provisions of the Act dealing with notice, hearings and determinations of liability will serve to protect the right to a fair and reasonable hearing for any person alleged to be liable, and provide adequate due process for all parties concerned.

I do recommend, however, that specific provisions be included in the Act to allow the Government to collect assessed penalties by the use of offset rights. The Act should specifically allow the Federal Government to offset from existing Government liabilities any amount for which an individual has been found liable under the Act. This will enable the Government to collect such damages in an expeditious manner. Since this bill provides adequate due process in determining liability, the Act should also not require the Government to duplicate these procedures in collecting through offset. For this reason, the Act should specifically exempt collection from the requirements of the Debt Collection Act.

In conclusion, I believe that this bill will provide an important weapon to the Department of Defense, as similar provisions have already been of great assistance to the Department of Health and Human Services in their campaign against fraud. It is ironic that HHS has had this authority to combat fraud in health programs, but that Department of Defense has not had this authority to deal with fraud on Defense contracts.

I look forward to working with Congress in developing a mechanism which will provide due process and enable the Government to effectively combat fraud.

Mr. Chairman, this concludes my statement. I am prepared to address your questions.

Senator COHEN. Our next witness is Karen Hastie Williams, a partner in Crowell and Moring and a former administrator of the much heralded OFPP, the Office of Federal Procurement Policy. She is testifying today on behalf of the Public Contract Law Section of the American Bar Association.

Ms. Williams?

TESTIMONY OF KAREN HASTIE WILLIAMS, CROWELL & MORING, ON BEHALF OF THE PUBLIC CONTRACT LAW SECTION OF THE AMERICAN BAR ASSOCIATION, ACCOMPANIED BY ALAN BROWN, ON BEHALF OF THE SECTIONS ETHICS IN GOVERNMENT AND FRAUD COMMITTEE

Ms. WILLIAMS. Thank you very much, Mr. Chairman.

I am pleased to be here in my capacity as chairman of the Legislative Liaison Committee of the Public Contract Law Section of the American Bar Association to testify on behalf of the Section before this subcommittee.

With me today is Alan Brown, the vice chairman of our Section's Ethics in Government and Fraud Committee. We will both be available to answer questions that you and other members of the committee may have at the conclusion of my remarks.

I would ask, Mr. Chairman, that my prepared statement be included in the record in its entirety, and in the interest of time, I will just highlight the issues about which the Section is particularly concerned.

Senator COHEN. That will be very helpful and your statement will be included in full, Ms. Williams.

Ms. WILLIAMS. Let me state at the outset, Mr. Chairman, that this statement represents the views of the Section, but has not been formally approved by the house of delegates or the board of governors of the ABA.

The members of the Section on Public Contract Law include a broad cross-section of lawyers from across the country, from the private bar, from government, from corporations, and from academia. However, the positions of the Section are developed independently as a group of public contract professionals after much study and constructive debate.

Our Section has consistently taken the position that legislation to correct abuses of the procurement system and fraudulent actions by contractors is an appropriate objective. Our concerns have always been addressed to the lack of due process protections to which every citizen of this country is entitled. We share the concerns of the Congress for the reduction and prevention of program fraud and seek to work with you in resolving fraud problems through legislation that will correct contractual abuses.

We have always supported creative efforts to improve Government procurement laws and regulations, as you know, from our strong support of the Competition in Contracting Act, spearheaded by this committee in the last Congress.

Our concerns with respect to past legislative solutions were not reflective of any single interest group, but were aimed at protecting the constitutional rights of all persons accused of fraud.

As this legislation, S. 1134, is considered, we think it is important to recognize that to potential defendants in proceedings under this bill include individuals, small businesses, and nonprofit organizations, as well as major corporations and contractors.

The assignment of fraud cases to administrative agencies for adjudication does mean that these persons lose their right to trial by jury and other significant protections which have heretofore been available. We remain concerned that in this process certain minimum standards of due process and fairness be maintained.

We commend the committee for its efforts to recognize that in the context of small amounts of money, which may not be retrieved by the Government—absent the cost-effectiveness of remedies of trial—that an administrative forum is appropriate. We think that the provisions of S. 1134 are a significant improvement over earlier program fraud bills. We commend you, Mr. Chairman, and the other members of the committee for working diligently, for working with outside organizations, the private bar, with Government agencies informally in the development of this legislation.

Many of the procedural deficiencies on which the ABA has testified in past hearings and which have played prominently in earlier versions of the legislation, such as those concerning contractor discovery rights, have been eliminated.

This bill clarifies that liability will be imposed only on a person who submits a claim that the person knows, or has reason to know, is false. This standard, in our view, would encompass those individuals who fraudulently submit claims within what has been called by the courts "reckless disregard for truth or falsity."

Thus, we believe that the bill does require some degree of intent. It is a significant change, in our view, from prior versions of the legislation which would have dealt with fraudulent situations through mistake or generally disputed claims.

So we think that as far as the standard is concerned, S. 1134 is a significant improvement.

Our prepared testimony identifies five specific areas where the Section has significant concerns. The effect of the legislation on the determination of potential suspension and debarment, the magnitude of possible penalties, the grant of testimonial subpoena authority to investigators, the protection of due process rights in both the accusatorial and adjudicative phases of the proceedings, and possible duplication of remedies.

I will highlight two areas this morning; debarment and suspension and the potential interaction of adjudicative, investigatory, and judicial requirements.

Our Section continues to be concerned that a finding of liability or even of probable cause under this legislation could lead, without additional review to an automatic suspension and debarment of a contractor under the procedures of the Federal Acquisition Regulation.

You pointed out very correctly, Mr. Chairman, in your statement introducing S. 1134 that the purpose of suspension and debarment, with which you and Senator Levin have been wrestling for a number of years, is not to punish, but, rather, to protect the interest of the Government.

We agree with you.

The FAR, in its provisions, requires an agency to consider any mitigating factors and provides that the existence of a cause for debarment does not necessarily require that the contractor be debarred. Unfortunately, in practice, this maxim has not been uniformly followed by the agencies.

The Department of Defense, in its recent Taft regulation, has indicated essentially an automatic debarment for a felony conviction. The reference——

Senator COHEN. If I could interrupt just interrupt for a second.

Ms. WILLIAMS. Yes.

Senator COHEN. I think Mr. Vander Schaaf indicated that it did not automatically result in debarment. In fact, he gave four or five examples where there were convictions in which they decided not to initiate debarment proceedings. So it didn't lead automatically to one.

Ms. WILLIAMS. There is a provision, Mr. Chairman, in the regulation for a waiver by the Secretary. There are many contractors who are small businesses who are universities, for example, and other organizations that cannot reach the Secretary under this waiver procedure.

I think that, while that provision is technically available, the reality is that many contractors do not have that remedy available.

Our concern is that a procedure exists; a mechanism whereby there is a separate debarment and suspension proceeding for the determination of present responsibility. And the language that we've suggested, which I think is a fairly minor modification of the language in S. 1134, will assure that this is a two-step process.

As Senator Levin pointed out earlier, there are many reasons, and we think valid reasons, as established under the law and the standards of collateral estoppel, why an agency should not have to go through a second proceeding to establish that certain things did occur.

But as to the impact of the first proceeding in terms of debarment and suspension, we do think that there should be an independent, second, proceeding. Our suggested modification of that language would provide for that.

The amendment that we have suggested which refers to section 802(b)(2). We believe it would clarify that while a determination of liability could establish in accordance with the well-known rules governing collateral estoppel that the particular improprieties occurred, it could not be used as a conclusive determination regarding the contractor's present integrity and responsibility. Before any suspension or debarment would be imposed, further proceedings would be required to consider factors such as those that you mentioned earlier—any disciplinary or corrective proceedings undertaken by the contractor, the involvement or noninvolvement of senior management in the alleged fraud, the contractor's reputation and past performance, the magnitude of the problem with respect to the contractor's business.

If that change is made, it would go a long way toward assuring the contracting community that these two proceedings, while they are related, one separate and will not result in an automatic action to debar and suspend.

Let me move on, in the interest of time, without diminishing the importance of the questions with respect to potential aggravation of penalties far in excess of the $100,000 ceiling that is in the legislation or the question of subpoena authority, which we do not think would be appropriate for an investigating official, to the question of the relationship between the investigative, prosecutorial and adjudicative functions within the administrative agency.

We have two principal concerns. First, in view of the substantial penalties that may be assessed under this bill and the potential effect of the determination of liability on suspension and debarment, we think it is critical that the adjudicator be a fair and independent person.

S. 1134 attempts to ensure this impartiality by requiring that the hearing examiners be high level officials appointed "in the same manner as administrative law judges."

We anticipate, and I think you've heard testimony earlier today, that most of the agencies will be using administrative law judges in this capacity. The Department of Defense, however, does not use administrative law judges and this bill would not authorize any additional personnel to be appointed for the positions of hearing examiners.

Thus, the possibility does exist that determinations of fraud may be made by senior program officials or military line officers rather than impartial quasijudicial officers. This situation provides neither the appearance nor the reality of fairness and due process.

If a small fraud case is going to be removed from the court system, we strongly urge that the bill be more explicit in its language and require, at a minimum, that cases be heard by full-time hearing examiners with the independence and stature of administrative law judges, military judges, or boards of contract appeal judges. The qualifications and independence of these individuals should be determined through a selection process that will ensure the integrity of the adjudicative process.

There are examples already within the agencies as to how administrative law judges are selected, how boards of contract appeal judges are selected under the Contracts Disputes Act. We think that these procedures provide appropriate models to ensure the integrity of this administrative hearing process.

An equally serious problem, in our view, occurs at the prosecution stage. Accusations by the Government, whether civil, criminal, or administrative, of fraud quickly become headlines in hometown newspapers. The damage to the reputation of individuals and businesses, particularly the smaller businesses, can be devastating. This damage is hardly cured later by a finding of innocence.

In light of the seriousness of these charges, we suggest that a more active role is appropriate for the Justice Department than is currently provided in the legislation.

As I understand the way the legislation would work in its current form, the Justice Department approval process is intended only to assure that agencies do not interfere with criminal prosecutions by the Justice Department. And there is a procedure whereby if the Justice Department doesn't act within a certain period of time, that the agencies can go forward.

We think that the Justice Department should have a more active role in terms of reviewing the cases on their merits and providing an independent, prosecutorial examination of the circumstances to determine whether probable cause exists and whether the accusation of fraud leveled by the United States is an appropriate one.

In my prepared statement, I've suggested several other areas of clarification that, in the section's view, would help to strengthen the legislation.

Mr. Chairman, the section again commends you for the significant improvements in this legislation. In particular the increased due process protections for all involved, will aid the credibility of the process in terms of the Government's proceedings, as well as in terms of the concerns of the contractors.

We are prepared to work with you and with your staff as you continue with the development of this legislation. Mr. Brown and I would be happy to respond to any questions that you or members of the subcommittee may have.

Senator COHEN. Ms. Williams, thank you very much. I particularly appreciated your comments about how the members of the staff have worked so closely with ABA and other outside organizations to produce what I think is a better bill. It's still in its evolutionary state, and we're always open to any recommendations that we think are responsible and reasonable.

I notice that last year, for example, you had expressed concern that virtually any noncompliance with contract terms or specifications would be defined as actionable fraud.

Well, under last year's bill, claims could be considered false if they provided for payment of property or services not provided in accordance with the terms of the contract.

We struck that language this year and thereby, hopefully, removed that particular potential abuse.

Let me just focus on one major issue which has come up during the course of this morning, and that is discovery rights, contractor discovery rights.

The Justice Department is pretty firmly opposed to that. We have tried to strike a balance. How do we avoid getting into discovery wars that are common in judicial proceedings? Have we struck the right balance by leaving that determination up to the hearing examiner as to whether discovery is necessary for the expeditious, fair, and reasonable consideration of the issues?

Ms. WILLIAMS. I think that the bill does do just that, Mr. Chairman. So many different situations are covered by this legislation, from a Government employee who submits a false voucher to a situation with a contractor submitting a voucher that has an erroneous overhead statement—and everything in between.

The hearing examiner, I think, will best be in a position to look at any particular situation and ascertain that minimal guidelines are in place to protect both parties.

It is important to protect the rights of the contractor and use the hearing examiner as the appropriate balance in terms of the scope of any discovery.

I might ask Mr. Brown to comment on that as well.

Mr. BROWN. Mr. Chairman, it is ironic that at the same time as the agencies are urging the committee to authorize them to subpoena individuals and compel testimony during the investigation, compel testimony, they would deny the individuals accused any discovery rights during the hearing.

Those positions seem to go in opposite directions.

As the amount of money involved in these cases increases, I believe that the protections that should be provided to the defendants should increase as well. I notice from Mr. Kusserow's testimony, that in the three cases that have gone to hearings, a total of nearly $2 million has been recovered. That's nearly $700,000 per case.

We're talking at this point about cases of substantial size that are being removed from the courts and assigned to agencies for imposition of substantial fines and penalties.

As these cases are removed from the courts, individuals are losing their right to a jury trial and other rights that are inherent in the judicial process. In transferring these cases from the courts to the agencies as many rights as possible should be preserved, including the right of individuals to present a defense by obtaining evidence from the Government through discovery.

Senator COHEN. A question, Ms. Williams. You indicated in your prepared testimony that the Justice Department has consistently opposed the inclusion of penalties for false statements. I believe that they have been undergoing some evolution in terms of their thinking. They originally expressed reservations back in 1982, but last year, they did not oppose it; and this year they actively support inclusion of penalties for false statements.

I think you've probably gathered as you've listened to the testimony this morning that the Government can, in fact, be injured by something other than a false claim. It can suffer injury, as such, to the integrity of the program when you have many different varieties of false statements being made and certifications which don't result necessarily in monetary damage per se, but, nonetheless, does constitute undermining the program itself.

So the Justice Department now has come out in support, very strong support, of Civil penalties for false statements.

Ms. WILLIAMS. I understand that. Traditionally, the Justice Department has viewed remedies in terms of false statements as appropriately kept in the criminal area as opposed to the civil area.

There has been a change, but I think it is tied into their broader management reforms, if you will. But we still feel that the penalty in terms of false statement should be reserved for the criminal area and are very concerned about the duplicative effect of penalties imposed for false statements, as well as false claims.

And let me ask Mr. Brown to elaborate on that point. Duplicate penalties are a serious problem and threaten to undermine a lot of the good and a lot of the improvements that we see in this bill when compared with earlier versions of the legislation.

Mr. BROWN. Well, Senator, there are several areas of concern relating to false statements, the first being the concept of whether agencies should essentially be given the authority to punish what is currently treated as a crime and has always been treated as a crime under section 1001 of title XVIII.

While false statements may cause programmatic damage and undermine the Government programs—that's the argument that's generally made as to the damage to the United States—there is no monetary loss to the United States as such. It is this monetary loss that has prompted the Supreme Court and other courts to label the False Claims Act as a remedial statute, even though it provides for double damages and statutory forfeitures.

The criminal law, I believe, provides sufficient deterrent and punishment for those who make false statements to the Government and false statements should continue to be treated as a crime.

Moreover, false statements can also provide the basis for a debarment proceeding and other administrative actions against the perpetrator of the fraud.

In addition, the bill, as written, would provide that in the case of a false statement relating to a claim for money, the individual shall also be subject to an assessment of double the amount of the claim. I believe this provision duplicates the false claims portion of this bill in that a person who has submitted a false claim which is supported by a false statement would be liable under section 802(a)(1) for submitting a false claim, and then would be liable again under section 802(a)(2) for having submitted a false statement in connection with a claim. In both instances, he could be held liable for double the amount of the claim.

If, in fact——

Senator COHEN. Double the amount falsely claimed.

Mr. BROWN. Yes, Senator. If false statements are to be punished, a $10,000 penalty, by itself, is more than sufficient punishment where there has been no monetary loss to the Government..

Senator COHEN. Well, it's up to $10,000. It could be $100, I suppose.

Mr. BROWN. It could be, Senator. But the bill would give the agency discretion to impose a penalty up to $10,000, and the appeal standard in the bill would appear to provide no basis for challenging in a court of appeals the amount of the penalty that has been imposed.

That is left to the sole discretion of the agency.

The Justice Department defends this in part solely on the basis of whether or not it's constitutional, which is a bit troubling. Much of the Justice Department's statement in support of this bill focuses on whether the provisions in the bill would pass constitutional muster.

It seems to me that when the United States is accusing individuals of fraud and transferring from the courts to agencies penalties of the magnitude that can be imposed under this bill, the test should not be to provide the minimum standards of due process that the Constitution mandates, but, rather, to ensure that reasonable standards of fairness are retained.

Senator COHEN. Thank you very much. Senator Levin?

Senator LEVIN. Thank you, Mr. Chairman. First, let me thank you for your valuable testimony. I just have a couple questions.

One is your suggestion, Ms. Williams, about the more active role that you propose for the Department of Justice in reviewing the merits of each case.

You are recommending that the reviewing official be an official of the Department of Justice, I understand. You've also said that the Justice Department approval process is intended only to ensure that agencies do not interfere with prosecutions by the Department of Justice.

That's not the way I read the bill's language. I read that the Department of Justice can deny, disapprove the referral of the allegation, for any reason, providing they specify the reason in subsection 3.

There is a later subsection which says that if continuation of the hearing would adversely affect a pending or potential criminal or civil action, then the hearing shall be stayed upon written authorization. But I view that provision as separate from the provision of the bill that provides for the Attorney General's approval, which could be withheld for any reason, as I read it.

Do you read it differently?

Ms. WILLIAMS. I think you're right, Senator, in the sense that it could be withheld for any reason. I think the practice has been with the agencies of Justice Department review, not in this context, but in similar contexts has focused ond issues where there is an impact on criminal litigation. For example, the contract fraud section that has been developed within the Department of Justice, to look at cases in terms of the impact on criminal prosecutions.

That has been the guiding light. There are Memoranda of Understanding between the Justice Department and other agencies about the prosecution of cases of this nature under existing law. Interference with criminal investigations has been the critical factor.

I was really talking from a pragmatic standpoint.

Senator LEVIN. Would a requirement that the Justice Department sign off on the reviewing official's decision to proceed satisfy you without turning them into the actual reviewing official?

Ms. WILLIAMS. I think that would certainly be an improvement over the current structure of S.1134. I think that it is necessary to have an independent prosecutorial review. Adding a second layer: I guess you're suggesting a reviewing official within the agency followed by a Justice Department sign off—that would be an improvement.

Senator LEVIN. Well, I'm not proposing that. I'm just exploring it.

Ms. WILLIAMS. I understand.

Senator LEVIN. I understand your point. I just want to explore various alternatives.

The other question I have relates to the debarment issue. As I look at your proposal on page 6 of your testimony, you would provide that the determination may be considered by the authority, but shall not be determinative of present responsibility.

The way you would read that word "considered by the authority," would you mean considered on the issue of whether or not to commence the suspension and debarment proceeding or considered during and as part of the debarment and suspension proceeding as evidence of some kind, or both?

Ms. WILLIAMS. Really both.

Senator LEVIN. Thank you.

Senator COHEN. Thank you very much, Ms. Williams.

Ms. WILLIAMS. Thank you, Mr. Chairman.

Mr. BROWN. Thank you.

Senator COHEN. We appreciate your testimony.

[Ms. Williams' prepared statement follows:]

PREPARED STATEMENT OF KAREN HASTIE WILLIAMS

Mr. Chairman and members of the Subcommittee, my name is Karen Hastie Williams. I am chairman of the Legislative Liaison Committee of the Section of Public Contract Law of the American Bar Association (ABA). With me today is Alan C. Brown, Vice Chairman of the Section's Ethics in Government and Fraud Committee.

We are pleased to testify on S.1134, the Program Fraud Civil Penalties Act of 1985. This statement represents the views of the Section but has not been approved by the House of Delegates or Board of Governors of the ABA. As such, it represents only the position of the Section of Public Contract Law and should not be construed as representing the position of the American Bar Association.

As the Committee is well aware, members of the Section of Public Contract Law include a cross-section of lawyers from the private bar, government, corporations and academia. However, the positions of the Section are developed independently as a group of public contract professionals after much study and constructive debate.

Our Section has consistently taken the position that legislation to correct abuses of the procurement system and fraudulent actions by contractors is an appropriate objective. Our concerns have always been addressed to the lack of due process protections to which every citizen of this country is entitled.

I regret that recent statements have interpreted our earlier expressions of concern as "resistance" to the legislation. I want to assure the Committee that the motivation of our membership is to ensure due process for all concerned. We share the concerns of the Congress for the reduction and prevention of program fraud and seek to resolve fraud problems through legislation that will correct contractual abuses. We have always supported creative efforts to improve government procurement laws and regulations as you know from our strong support for the Competition in Contracting Act. Our concerns with respect to past legislative solutions were not reflective of any single interest group, but were aimed at protecting the constitutional rights of persons accused of fraud.

As this legislation is considered, however, it is important to recognize that the potential defendants in proceedings under this bill include individuals, small businesses, and non-profit organizations, as well as major corporations and contractors. The assignment of fraud cases to administrative agencies for adjudication means that these persons will lose the right to a jury trial and other significant protections which have heretofore always been available. We remain concerned that, in this process, certain minimum standards of fairness and due process are maintained.

As the Committee is aware, more than 400 statutes and regulations already provide the Government with criminal, civil and administrative remedies to deal with contractor fraud. Nonetheless, we recognize that in some cases involving small amounts of money there may be no cost-effective remedy available to the Government. In these instances, the cost of a suit in a district court for double damages and statutory forfeitures under the False Claims Act, 31 U.S.C. §3729, may exceed the potential recovery. In this limited context, we agree that the creation of an administrative forum for resolution of actions analogous to those authorized by the False Claims Act may be justified. Another alternative would be the enactment of new legislation to amend existing statutes to strengthen the administrative procedures and sanctions for fraudulent actions. For example, disputes relating to government contracts are covered by the Contracts Disputes Act of 1978, 41 U.S.C. 2 §601 et. That statute already provides a comprehensive administrative mechanism for government claims against contractors, and could easily be amended to extend its procedures to claims involving fraud, consistent with the goals of S.1134.

We are pleased that S.1134 is a significant improvement over earlier program fraud bills. The Chairman and his colleagues are to be commended for efforts to involve outside organizations and the private bar in the discussions leading up to the drafting of this legislation. Many procedural deficiencies which plagued earlier versions of the legislation, such as those concerning contractor discovery rights, have been eliminated.

For example, the bill clarifies that liability will be imposed only on a person who submits a claim that the person "knows or has reason to know" is false. This standard would encompass those individuals who fraudulently submit claims with what the Eighth Circuit calls "reckless disregard" for their truth or falsity, or what the Fifth Circuit has termed "deliberate ignorance." (See United States v. Cooperative Grain & Supply Co., 476 F.2d 47, 60 (8th Cir. 1973); United States v. Mattox, 689 F.2d 531, 533 (5th Cir. 1982); United States v. Schaffer, 600 F.2d 1120, 1122 (5th Cir. 1979).) The bill would nonetheless require some degree of intent. This change from prior bills properly excludes mistaken or genuinely disputed claims from the coverage of the legislation.

We remain concerned, however, with some aspects of S.1134. Today, I will highlight five major areas about which the Section is particularly concerned:

- the effect of a determination under this bill on a potential suspension or debarment;
- the magnitude of the possible penalties;
- the grant of testimonial subpoena authority to investigators;
- the protection of due process rights in both the accusatory and adjudicative phases of the proceedings; and
- the possible duplication of recoveries.

Debarment and Suspension

One of our Section's serious concerns is that a finding of liability, or even of probable cause, under S.1134 could lead without more to a suspension or debarment of a contractor under procedures of the Federal Acquisition Regulation. (FAR 9.406 and 9.407). FAR 9.407-2 provides for suspension for "commission of fraud . . . in connection with . . . (iii) performing a public contract or subcontract." Under these regulations, there would be no independent prosecutorial review or trial-by-jury, and a contractor could be suspended without a prior hearing upon the determination of a single agency official that "probable cause" exists for a proceeding under this legislation..

The Chairman in his statement accompanying the introduction of this bill correctly noted that the purpose of suspension and debarment is not punishment, but rather to protect the interests of the Government. Consistent with this philosophy, the FAR requires agencies to consider any mitigating factors, and provides that the existence of a cause for debarment does not require that the contractor be debarred. FAR 9.406-1. Unfortunately, this maxim is not followed by the agencies.

The Department of Defense, for example, has provided in its FAR Supplement that as a practical matter, debarment will follow a felony conviction. DFAR 9.406-1(d) provides that in actions based upon a conviction "mitigating factors may only be considered in determining the period of debarment" -- not whether a debarment will in fact be imposed. Similarly, DFAR 9.406-4 provides that the period of debarment "shall be commensurate with the seriousness of the crime." These regulations provide no room for a determination of the contractor's present integrity or responsibility, but impose debarment as an additional penalty on the contractor. There is a legitimate concern among contractors -- especially the smaller contractor who cannot reach the Secretary to seek a waiver of these rules -- that a finding of liability for fraud under this bill would similarly trigger a suspension or debarment.

There are many who believe that, given the dissimilar nature of the proceedings and consequences, determinations under this bill should have no bearing whatsoever on a possible debarment or suspension. The principal concern, however, that a finding of liability under this legislation would inevitably lead without more to debarment, could be alleviated by amending §802(b)(2) to read as follows:

> A determination referred to in paragraph (1) of this subsection may be considered by the authority, but shall not be determinative of present responsibility, and shall not require such authority to commence any administrative or contractual action which is authorized by law.

This amendment would clarify that while a final determination of liability could establish in accordance with well-known rules governing collateral estoppel that the particular improprieties occurred, it could not be used as a conclusive determination regarding the contractor's present integrity and responsibility. Before any suspension or debarment could be imposed, further proceedings would be required to consider such factors as the lapse of time, any disciplinary or corrective measures undertaken by the contractor, the involvement or non-involvement of current management in the alleged fraud, the contractor's reputation and past performance record, and the magnitude of the problem with respect to the contractor's business. This change would confirm that debarment is intended to protect the Government's interests, and is not an additional penalty to be imposed upon contractors found liable under this legislation.

Potential Penalties

A second area of significant concern to the Section is the magnitude of potential penalties that could be imposed under this legislation. First, Section 802(a)(1) appears to provide that a person submitting a false claim may be assessed a penalty of $10,000 for each such claim, and in addition, in lieu of damages, "twice the amount of such claim." This section should be clarified to provide that the assessment is limited to twice the amount of the damages suffered by the Government as is provided under the False Claims Act. Permitting an assessment of twice the face amount of the claim could result in multimillion dollar assessments being imposed where the fraudulently claimed amount is less than $100,000. For example, if a $1 million claim was inflated by only $50,000, the bill could be interpreted to authorize a $2 million assessment, plus a $10,000 penalty. We do not believe this result was intended by the drafters, nor would such a draconian penalty be justified.

Second, §802(a)(2) which permits the imposition of penalties and assessments for false statements irrespective of any damages suffered by the United States is inconsistent with the purpose of this legislation. As I indicated before, we understand that this bill was intended to provide the Government with a remedy similar to the False Claims Act in small cases in which court litigation is not cost-effective. The False Claims Act is a remedial statute. The purpose of the double damages and statutory forfeitures under that statute is to ensure that the Government is completely compensated for any loss it has suffered. See United States v. Bornstein, 423 U.S. 303, 314 (1976). On the other hand, false statements which result in no damage to the United States have always been punishable as a criminal offense under 18 U.S.C. §1001. That statute provides ample punishment and deterrence where no compensation is necessary.

By permitting penalties to be imposed for false statements unrelated to any claim or loss to the Government, S.1134 is transformed from a remedial to a penal statute. Rather than creating an administrative False Claims Act, the bill would assign to the agencies the prosecution and adjudication, without a jury trial, of what has heretofore always been considered a criminal proceeding. This problem is exacerbated by the fact that the dollar limitation of §803(c) is linked to the amount of damages -- not the size of the assessment. Consequently, there is no limit on the amount of penalties which can be imposed by an agency for false statements where those statements have not resulted in any loss to the Government. For these reasons, we believe §802(a)(2) of the bill should be deleted in its entirety.

We would also note that, for similar reasons, the inclusion of penalties for false statements has been consistently opposed by the Department of Justice. *See*, *e.g.*, Testimony of Assistant Attorney General J. Paul McGrath, Hearings before the Committee on Governmental Affairs, United States Senate, on S.1780, (April 1, 1982) at 15.

Third, §803(c) should be amended to place a ceiling on the total amount of assessments and penalties which may administratively be levied against defendants. By basing the ceiling on the amount of the Government's *damages*, the bill would authorize agencies to impose multimillion dollar penalties where numerous false invoices or statements are submitted, even though the Government has suffered little or no loss. For example, a contractor, or a Federal employee, who submitted one hundred false travel vouchers for reimbursement over a five year period could be penalized $10,000 per voucher -- a total of *$1 million* -- even though the total overcharge was only a few hundred dollars. We firmly believe that it would be inappropriate to permit such drastic penalties to be imposed while at the same time denying the right to a trial by jury. If penalties of this magnitude are warranted in the particular circumstances, a suit by the Justice Department in a district court would be the appropriate course.

Subpoena Authority

The Section is also concerned over impact of providing testimonial subpoena power to the investigating official, i.e., Inspector General.

The bill would grant the Inspectors General and other "investigating officials" the power to require by subpoena the attendance and testimony of witnesses. This is a significant departure from existing law. See United States v. Iannone, 610 F.2d 943, 946 (D.C. Cir. 1979). While certain independent regulatory agencies such as the Securities and Exchange Commission can compel testimony in the course of their regulatory functions, the functions of the Inspectors General are quite different.

The Inspectors General are not regulators, but investigators. Their functions are akin to the Federal Bureau of Investigation which has long functioned without the powers sought here. Similarly, the Department of Health and Human services has successfully pursued administrative investigations under the Civil Monetary Penalties Law without the need for compelled testimony. "Probable cause" under this bill can be determined without compelled testimony. Once that determination is made and a proceeding is commenced, further evidence can be developed through the discovery procedures provided in the bill in the same manner as in a civil proceeding, including those under the False Claims Act.

Providing new authority to compel testimony is particularly misplaced in this legislation. Since the investigation will take place before the determination of the Government's damages, the power to compel testimony will not be limited to the small cases to which this legislation is directed, but will be available to the Inspectors General in all investigations. The result of this bill, then, would be to amend significantly the Inspector General Act of 1978. If this substantial new authority is to be provided, we urge that it be considered in the context of an amendment to the Inspector General Act after full consideration by the Congress of its necessity and ramifications.

Again we would note that the grant of testimonial subpoena power to the Inspectors General has been consistently opposed by the Department of Justice. *See* Testimony of J. Paul McGrath, *supra*, at 29.

Due Process Concerns

In creating this remedy, S.1134 would combine the investigative, prosecutorial and adjudicative functions in each administrative agency. Two aspects of this combination are cause for serious concern.

First, in view of the substantial penalties that may be assessed under this bill, and the effect of a determination of liability on a possible suspension or debarment, it is crucial that the adjudicator be fair and independent. S.1134 attempts to ensure this impartiality by requiring that hearing examiners be high level officials, appointed "in the same manner as administrative law judges." We anticipate that, in most agencies, cases under this legislation would be heard by administrative law judges (ALJ's). The Department of Defense, however, employs no ALJ's, and this bill would not authorize any additional personnel positions for employment of hearing examiners. The possibility thus exists that determinations of fraud may be made by senior program officials or military line officers, rather than impartial, quasi-judicial officials. This situation provides neither the appearance or reality of fairness and due process.

If small fraud cases are to be removed from the courts, we strongly believe the bill must require, at a minimum, that the cases be heard by full-time hearing examiners with the independence and stature of administrative law judges, military judges, or Board of Contract Appeals judges. The qualifications and independence of these individuals should be determined through a selection procedure which will ensure the integrity of the adjudicative process. For example, ALJ's are selected from a register maintained by the Office of Personnel Management, and Boards of Contract Appeals have developed a comparable procedure for establishing a register of highly qualified candidates. The need for this type of process was recognized during consideration of the Contract Disputes Act. See, S. Rep. 95-1118, 95th Cong., 2d Sess. at 24. A similar register using objective criteria and selection methods could be used for selection of hearing examiners under this legislation. Such a process will insulate the examiners from the influence of the agencies in which they serve. The bill should further specify that these officials shall have no duties or responsibilities inconsistent with their function under this legislation. We recommend that, at a minimum, § 801(a)(8)(A), line 23, have the words "selected and" inserted before the word "appointed."

An equally serious problem exists at the prosecution stage. The United States bears a major responsibility in publicly accusing individuals and companies of fraud. Such accusations by the Government -- whether criminal, civil, or administrative -- quickly become headlines in hometown newspapers. The damage to the reputation of the individuals or businesses -- particularly small businesses -- can be devastating. This damage is rarely cured by a later finding of innocence.

Considering the serious nature of charges, it is important that an official who is isolated from the political and programatic concerns of the agency review the merits of the case before a proceeding is commenced. The Department of Justice currently provides this independent prosecutorial review in suits under the False Claims Act. Many cases of alleged fraud referred by agencies are closed by the Department of Justice for lack of merit because the agency's allegations are exaggerated or unfounded, or because it is apparent to the Justice Department that no fraud has occurred. Under S.1134, however, the "reviewing official" could be any senior agency official, including the individual responsible for the program involved in the alleged fraud. This raises the possibility that persons may unjustly be accused of fraud to hide mistakes or mismanagement by the agency.

This problem could be solved, while preserving the purpose of this bill, by assigning the proposed administrative remedy to the Department of Justice. Thus, cases could continue to be referred by agencies, and the Justice Department could choose to proceed under the False Claims Act, or in small cases to pursue an action before a Department of Justice administrative law judge.

At a minimum, S.1134 should assign to the Department of Justice the responsibility to act as the "reviewing official." As currently conceived, the Justice Department approval process is intended only to ensure that agencies do not interfere with prosecutions by the Department of Justice. This function should be expanded to require a more active role by the Department of Justice in reviewing the merits of each case. This would insure that an independent prosecutor has determined that probable cause exists before accusations of fraud are leveled by the United States.

Duplication of Remedies

Sections 802(a)(1) and (2) of the bill provide that the penalties and assessments under this bill are "in addition to any other penalty that may be prescribed by law." Some commentators have suggested that these provisions authorize the Government to recover double damages and penalties under this bill, and also, on the same facts, to recover double damages under the False Claims Act, forfeiture of the inflated amount of the claim under the Contract Disputes Act, or single damages under the Truth in Negotiations Act. By this logic, the bill would authorize the recovery of treble or quadruple damages for a single false claim. Indeed, under this interpretation, the Government, having lost a False Claims Act suit in court, could nonetheless assess double damages under this bill administratively for the same false claim.

We do not believe the Committee intended this result. These provisions should be clarified to provide that while the remedy in this bill does not replace or supercede existing remedies, longstanding principles of election of remedies and merger would apply to bar multiple recoveries on the same set of facts. Any amount recovered in a civil suit, administratively, as restitution, or otherwise, would be credited against the penalties and assessments levied under this bill. This interpretation is consistent with well established rules under the False Claims Act. See United States v. Bornstein, supra; United States v. Thomas, 709 F.2d 968, 972 (5th Cir. 1983); United States v. Foster Wheeler, 447 F.2d 100 (2d Cir. 1971).

Other Clarifications

The four areas discussed above are the Section's principle concerns with S.1134. The following are additional areas in which clarification should be provided:

- Section 803(c) should be clarified to provide that the $100,000 limitation applies to any claim or group of related claims. A single set of facts should not be split into several separate proceedings simply to avoid the limitation of this section.
- The same standards for appellate review which govern other administrative sanctions under the Administrative Procedure Act (5 U.S.C. §706) or the Contract Disputes Act (41 U.S.C. §609) should also apply to judicial review under this legislation. Accordingly, §805(c) should be amended to read: "The findings of the hearing examiner with respect to questions of fact shall be final and conclusive and shall not be set aside unless the decision is fraudulent, or arbitrary or capricious, or so grossly erroneous as to necessarily imply bad faith, or if such findings are not supported by substantial evidence." This proposed language is adopted from the CDA.
- Section 801(a)(6)(B) allows any employee of an agency without an Inspector General to be appointed an "investigating official." The bill should place limits on who may be assigned this responsibility, particularly in view of the testimonial subpoena power which the bill would provide to that individual.
- The bill should specify that hearings are to be held where the defendant is located. Considering the size of the claims encompassed by this bill, it is likely that many cases will be brought against individuals and small businesses. Allowing an agency to

> require the defendant to travel to Washington would be tantamount to the denial of a hearing in many such cases.

Conclusion

To summarize, let me conclude with specific responses to the three questions propounded by Senator Cohen in his letter inviting the Section to testify on S.1134.

First, we agree that there is presently no cost-effective remedy available to the United States to obtain compensation in fraud cases involving small amounts of money. In such cases, the cost of court litigation using existing remedies may exceed the possible recovery. The administrative remedy which would be created by S.1134 constitutes a reasonable response to this problem. At the same time, it is important to recognize that the result of this bill is to deprive defendants of a jury trial and other protections which are available under current law. Consequently, we believe that the availability of this remedy should be strictly limited to the small cases in which it is needed, and that the right to a jury trial should be preserved in all cases in which it is economically viable. We also believe that the administrative remedy should be remedial -- not punitive -- and should provide a means by which the Government can obtain compensation for its losses in a manner analogous to suits under the False Claims Act. The expansion of this concept to permit agencies to "fine" or otherwise punish false statements where no loss to the Government has resulted is not warranted.

Second, the bill should specifically provide that a finding of liability under this bill is not, by itself, sufficient to justify a suspension or debarment. While the result may be considered by the debarring official, a further determination that the contractor is not presently responsible to do business with the Government is necessary before a debarment or suspension may be imposed.

Third, we believe that S.1134 has significantly increased the due process protections provided to defendants over previous program fraud bills. Nonetheless, we remain concerned by the combining of the investigative, prosecutorial and adjudicative functions in the very agency whose program was allegedly defrauded. This combination increases the risk that the determinations may be influenced by political and programmatic considerations. As previously detailed, we urge that the bill more clearly require that hearing examiners be independent, full time administrative judges. We also advocate a more active role for the Department of Justice in the reviewing process to ensure that the United States does not unfairly accuse persons of fraud.

We again commend the Committee for focusing its attention on many of the concerns the Section has noted with respect to past proposed legislation. We look forward to cooperating with the Committee in meeting its objective of developing meaningful legislation to remedy program fraud.

Mr. Chairman, we are available to respond to any questions that the members of the Subcommittee may have.

* * *

Senator **Cohen**. Our final witness this morning is Mr. Rhett Dawson, with whom I had the pleasure of working when he served as staff director of the Senate Armed Services Committee. Mr. Dawson is now a partner in the law firm of Dickstein, Shapiro, & Morin. Today, he is representing the Aerospace Industries Association.

Last, but not least.

TESTIMONY OF RHETT B. DAWSON, DICKSTEIN, SHAPIRO & MORIN, ON BEHALF OF THE AEROSPACE INDUSTRIES ASSOCIATION

Mr. **Dawson**. Good morning, Mr. Chairman, Senator Levin.

I am Rhett Dawson and today I am appearing on behalf of the Aerospace Industries Association of America, a trade association representing the Nation's major manufacturers of commercial, military and business aircraft, helicopters, aircraft engines, missiles, spacecraft, and related components and equipment.

Thank you for giving us the opportunity to comment on this legislation.

No responsible citizen or organization can in good conscience oppose the laudable efforts of this committee to deal with the frustrating problem of fraud perpetrated upon our Government. It is plain that such fraud is a wrong that deserves redress.

We have examined this bill closely and believe that it does, indeed, address this wrong in a manner that is an improvement upon its predecessors.

Nevertheless, we have serious doubts that S. 1134, as it is now drafted, is the vehicle by which that wrong is properly righted. This bill, whose ambit embraces virtually every claim made to or against the Government in an amount less than $100,000, sets up an administrative process of awesome power. The investigatorial, prosecutorial and judicial features of this administrative process pose grave policy questions in that they create a new system of investigation and adjudication that has none of the formal protections that have been historically accorded to civil defendants liable for fines and/or damages.

Almost any dealing that a private citizen or corporation has with its Government, either directly or through private, local or State government entities, subjects that citizen or corporation to the investigative whim of the Federal agency affected.

Because aerospace industry is so heavily involved with the Federal Government, and because of the extraordinary complexity of the Government procurement process, and, indeed, of the items procured, the provisions of this bill have a special and a readily discernible impact upon this industry.

We are primarily concerned with four issues that arise from the provisions of this bill. First, there appears to be a question about the interpretation of the bill's knowledge standard, a claim that the person "knows or has reason to know."

We believe that the standard of knowledge in S. 1134—"knows or has reason to know"—imports a level of conscious culpability and is a reasonable one to consider if the committee explicitly embraces its commonly accepted judicial meaning.

Such meaning indicates that one has reason to know a fact only if a reasonable person in his position would infer such fact from other facts already known to him. This is the minimum acceptable standard for a statute that provides such a substantial punitive sanction and has such broad application. We raise this point to dispel confusion that might arise from other interpretations that might be inserted into the record.

In June 1982, Richard Kusserow, inspector general of HHS, who also testified today, wrote, and in November 1983 submitted a discussion of the Civil Monetary Penalties Act of 1981. That was inserted into the hearing record of a predecessor bill to S. 1134.

In the Federal Register of August 26, 1983, at page 38,831, which was also inserted into an earlier hearing record, HHS made clear that, in its view, under the knowledge standard, "knows or has reason to know," a prosecutor need not show actual knowledge, but simply that the claimant should have known, stating additionally that "the statute sweeps within its ambit not only the knowing, but the negligent, and we are obliged to give it its scope."

In light of such radically different interpretations that would very likely lead to radically different results, we believe that the committee should make plain in the definition section of the bill that agencies affected are to follow the consistent, common law interpretation of the phrase, "knows or has reason to know," that I outlined above.

Second, this bill, which reaches both $3 and $33,000 frauds, should provide guidance to agencies on the level of due process and procedural safeguards applicable to those accused of false statements or frauds.

The summary treatment available under this bill for a $3 fraud is not the type of treatment appropriate for or expected by a contractor who may pay over $200,000 in penalties and may face the debarment of his business from Government procurement. And neither treatment would give the accused anything approaching the rights they would normally be accorded in a Federal court.

Third, another major concern derives from S. 1134's provision that hearing examiners are to be employees of the same authority which brings the false claim action and that they are to be appointed by, and, presumably, be answerable to, the same authority head who appoints the reviewing official and the investigating official.

We believe that where penalties can be as substantial as under this bill, and where the investigator, prosecutor, and hearing examiner all are appointed by, work for, and answer to the same authority head, who then functions as the sole administrative appellate forum, there is insufficient insulation between actors to assure impartial and fair determinations.

A final, most serious concern is the interrelationship between suspension and debarment regulations and this bill. Under S. 1134, a finding of probable cause by reviewing official that a contractor had submitted a false statement, even by omission, may well be sufficient to sustain a suspension and a judgment under this bill could itself be authority for debarment.

The suspension and debarment regulations were carefully developed to provide for those serious penalties only in cases where they are merited. Passage of this bill in its present form could allow suspension and debarment, among the most serious punishments for a Government contractor, for the most innocuous of unintentional omissions.

If this bill is warranted by substantial problems of program fraud that are not currently addressed by the Department of Justice, it is our firm belief that it should be amended to resolve the concerns and problems we have raised. The creation of a new investigatorial, judicial and administrative process with the power to levy substantial penalties is a serious matter.

I thank the committee for having given me this opportunity to communicate the views of the Aerospace Industries Association of America and I am available for any questions the committee might have of me.

Senator COHEN. Thank you very much, Mr. Dawson, for summarizing your testimony.

A couple of points of clarification. You indicated that the commonly accepted judicial interpretation of the phrase, "know or reason to know," requires actual intent or specific intent.

Could you cite for the committee, not now, but perhaps in writing, those cases which lead you to that conclusion?

Mr. DAWSON. I will be happy to, but I don't think my testimony was intended in any way to suggest that "knows or has reason to know" requires specific intent. I did not intend to do that and if I was not clear on that in my record, I apologize.

Senator COHEN. I was under that impression.

Mr. DAWSON. No, I spoke about intent in the context of a general intent or a conscious culpability, not requiring the ill-will or evil state of mind that one is familiar with in the criminal specific intent context.

Senator COHEN. Would that include gross negligence, for example? Suppose you had a situation, and we've discussed this, and I know you've been in the audience waiting to testify, where a contractor seeks to put layers of insulation between himself and ultimate culpability.

I happened to mention E.F. Hutton before. I found that to be an outrageous situation, where top executives laid it all off on some midlevel personnel. The people at the top certainly had reason to know what was going on.

But how do you deal with the ostrich-like problem?

Mr. DAWSON. The case where you have an individual who has culpably avoided knowledge is clearly covered, in our opinion, by the "knows or has reason to know" standard.

Where we have difficulty making these distinctions, and I must quickly point out that these distinctions are as slippery and as elusive for everybody as they are for you and me, is the difference, the fine line, between "gross negligence," and culpable avoidance. How many facts do you need to have to alert you, to tip you off, that something is wrong? How repeated must the behavior pattern be?

But based upon our experience with having seen what agencies can do, given broad discretion to decide what these things do mean, as we saw in the case of HHS, they can end up taking "reason to know" and turn it into a negligence standard.

So the purpose of this discussion in our record statement was to urge you to be more concrete and absolutely crystal clear as to your meaning because it is our experience so far that agencies will broaden the interpretation, if allowed.

Senator COHEN. You indicated in your prepared testimony that this particular bill would allow for people to be punished for innocent or inadvertent mistakes.

Are you aware of any cases in which individuals have been penalized under the civil False Claims Act—which we have really based this particular measure on—for inadvertent or innocent mistakes?

Mr. DAWSON. No, but my recollection was—at least I got the impression that both Mr. Kusserow and Mr. Vander Schaaf said that negligence could be punished under their understanding of "reason to know." Mr. Kusserow clearly said it. It is in the regulations that promulgate the HHS money penalty statute.

I'm not aware of any cases, but he led me to believe from his testimony that that is entirely possible.

Senator COHEN. Another point—ALJ's. Would you have substantial comfort if all of the hearing examiners were in fact ALJ's?

Does that make a difference?

Mr. DAWSON. Yes, sir. I think that would go a long way toward providing some uniformity in the system and it would provide a group of competent, trained, technical people who would decide these cases. It would not leave the issue to what is now under the bill, 6,000 civil servants, and, I don't know military end strengths these days for general officers, another 1,000 general officers.

That's 7,000 hearing examiners, potentially. I think that invites disparate results.

Senator COHEN. And a final point. I think we should make it very clear that it's not the intent of this bill to in any way automatically trigger a debarment or suspension proceeding by virtue of a finding of liability under this act. This finding would be evidence, however, that the agency certainly could use in pursuing its debarment or suspension activities.

But I think that perhaps we can clarify that it is not intended to be an automatic trigger. It may be used by an agency as evidence we intend would be a separate proceeding. But that will be cleared up during the course of the discussion and revision of the bill.

Senator Levin?

Senator LEVIN. Thank you, Mr. Chairman. I also want to welcome Mr. Dawson. We haven't seen you for awhile.

Mr. DAWSON. Thank you.

Senator LEVIN. You look like you're prospering. [Laughter.]

Mr. DAWSON. That's usually translated, I'm putting on weight. [Laughter.]

Senator LEVIN. Oh, OK. First, that question of negligence. I don't think Mr. Vander Schaaf adopted the negligence standard for reason to know. I think he quite clearly said that he would require something more than negligence. I specifically asked him where he would draw the line and I think he said gross negligence.

As far as Mr. Kusserow is concerned, I don't remember his testimony in that regard. You have quoted something which he wrote in November 1983, where you do quote him saying negligence. And if he didn't testify clearly on this issue today, I'd like to ask him a question for the record in that regard as to where he would draw the line, if, in fact, that's the way he slices this continuum. I'm not sure that he even would slice it quite that way. But I would like to ask him that question for the record, Mr. Chairman, in the event he wasn't clear today.

I'm not sure that that is a radically different interpretation, however, from Mr. Vander Schaaf's. In any event, your written testimony says that these are radically different interpretations. I think that these are important differences, but I don't know that they're radically different.

Mr. DAWSON. Well, they are certainly disregarded distinctions, Senator.

Senator LEVIN. They're certainly what?

Mr. DAWSON. Disregarded distinctions. These are highly relevant distinctions. And if you believe, as we do, that the agencies are likely to disregard them further, unless you make them very clearly, they will broaden whatever authority you give them.

That's the essential point that we were trying to make.

Senator LEVIN. Well——

Mr. DAWSON. By the way, Mr. Kusserow's statement appears in the previous hearing record. It is available.

Senator LEVIN. Yes. I know you do quote it.

Mr. DAWSON. What he says now would be obviously very useful, but this is right out of the Federal Register, that tells the agency how to interpret the standard in the prior statute.

So you can see that they are disregarded in some cases.

Senator LEVIN. I just would tell you that I don't think that these are radically different interpretations. That's my only point. As your testimony says, I think they are important, these differences, but I don't think that they're radically different.

I would just point that out to you.

But I also want to ask you about what the chairman did, and that's this consistent common law interpretation. Are you saying that judges have consistently interpreted this phrase as the restatement, has interpreted it?

Mr. DAWSON. Before I answer that, let me just comment on one thing you said a second ago.

In asking Mr. Kusserow questions for the record, I would offer that you ask him to cite cases where "reason to know" has been interpreted as including simple negligence.

Senator LEVIN. That is a fair request, assuming that that continues to be a standard. And it may. I've forgotten his testimony this morning as to whether he reiterated that standard. You've indicated he's used it before and maybe he did again this morning.

In any event, we can ask him for those cases which support his interpretation.

But my question is are you saying that the cases have consistently interpreted "reason to know" in the way the restatement (second) has defined it? Is that what you're representing here?

Mr. DAWSON. I am suggesting that the restatement of Agency and Torts is the most authoritative treatise in American law and that I will bow in my interpretation of cases pretty quickly to those restatements of American law.

The restatement is what I used as the basis for arguing the meaning of "reason to know."

Senator LEVIN. Is it fair to say, then, that you assume, as I do frequently, that the restatement reflects the consistent common law interpretation, but you have not necessarily researched the decisions to see if that assumption is accurate?

Is that a fair summary of where we are?

Mr. DAWSON. We did some research, but one thing that I would suggest to you is that cases that deal with this are usually fact-laden. Many cases themselves have very tenuous grasps on the understanding of what is the current state of the law. I looked at the restatement because I thought it was the place to look.

Senator LEVIN. That's fine. I'm not challenging as to whether it's the place to look or not. I'm just saying that you assumed that it represents the majority view of the common law.

Mr. DAWSON. Right.

Senator LEVIN. And that we don't necessarily know whether it does and perhaps we can ask our staff to ask the legal division over at the American Law Division—is that what we call it?

Yes. OK. The other area has also been covered by the chairman, and that's the question of debarment and suspension. I don't view this language as resulting in an automatic suspension or debarment, either. I think your testimony is that it could lead or that it would automatically lead, or might automatically?

Mr. DAWSON. I'm sorry. I did mean to testify that the bill as drafted would require automatic suspension or debarment. The gist of my testimony was in a case where, again, "reason to know," could be interpreted as mere negligence and, second, where the basis for liability being near negligence could be used in a later suspension and debarment proceeding, that whole sequence of events becomes rather frightening. The point was to argue that you should be especially careful to disconnect the two proceedings.

Senator LEVIN. Would you agree that if a contractor doesn't know because he's insulated himself from knowledge, without any particular wrongful intent, that he's insulated himself from knowledge, so he's not put in the position of knowing—he doesn't assume anything wrong is going to happen. He doesn't assume any false claims. He just doesn't want to know. He just doesn't want to be in the position of having to check out all these representations by the millions that his company is making, or hundreds of thousands or tens of thousands, but that he consciously insulates himself from that knowledge—would that, under your definition of "should know," or whatever the language is in the bill, would that qualify?

Mr. DAWSON. Well, there is no bright line in these distinctions and they are fact-laden. And as you talked—and your question clearly goes to the nub of the problem—where you have 3 feet of statements in a proposal—not a claim, a proposal to the Government to do something, every unintentional mistake could, as interpreted by some, be punishable under this statute, how much are you going to require the individual signing that proposal to verify that every fact is, indeed, true to the best of his knowledge?

The false claim issue that you talked about when you were examining an earlier witness is our concern.

Senator LEVIN. Do you accept the grossly negligent standard?

Mr. DAWSON. No, sir; not as I understand. And, admittedly, the problem is because we think it would lead to a looser standard than what is commonly referred to as gross negligence. I'm arguing to err against this experience by climbing up one rung on the standard of knowledge ladder.

Senator LEVIN. Well, you want it two rungs from Mr. Kusserow and one from Mr. Vander Schaaf.

Mr. DAWSON. That's fair. [Laughter.]

Senator LEVIN. And you wanted it reckless?

Mr. DAWSON. No, I did not argue for reckless.

Senator LEVIN. Where do you want it?

Mr. DAWSON. Reason to know being used in the commonly accepted judicial meaning, requiring conscious culpability, requiring that the person who signs the claim must be put on guard by some fact. He must be tipped off. And a tip-off would be, to go back to your previous question, would be if you said, "I don't want to know about any of this. Whatever you do is all right with me. Don't let me know about these things"—the "ostrich" effect that Senator Cohen was talking about earlier—that's a fact, that's enough of a fact to tip off, to make someone liable.

Senator LEVIN. So that this person has to be tipped off, or that a reasonable person would have been tipped off?

Mr. DAWSON. That a reasonable person would be tipped off.

Senator LEVIN. This person doesn't have to be tipped off or put on guard, but a reasonable person would have been put on guard.

Mr. DAWSON. That's correct.

Senator LEVIN. But insulating yourself from being put on guard is OK.

Mr. DAWSON. No; insulating yourself is enough of a fact to put someone on guard. Therefore, the individual is tipped off.

Senator LEVIN. Well, but, insulating yourself doesn't tip off a reasonable person. You don't want to be put on guard. That's why you insulate yourself.

Mr. DAWSON. There is a legal term that is called culpable avoidance, where you purposely say, give everything to Joe because we're not going to tell Joe what we're doing. Joe should be tipped off if he is aware of the conspiracy or the tacit agreement by his subordinates not to tell him anything. But, as I said, these are enormously slippery, elusive concepts.

Senator LEVIN. Well, but I want to try to just pin it down a little further. You're saying that if you consciously insulate yourself so that neither you nor a reasonable person would be tipped off, that's OK.

Mr. DAWSON. OK, meaning it's acceptable to the association?

Senator LEVIN. That would not be a violation of the statute. You would not be liable under this.

Mr. DAWSON. In your hypothetical, am I aware of the fact that I have been insulated? Do I know people are——

Senator LEVIN. You've insulated yourself because you don't want to know. You don't want to be in a position.

Mr. DAWSON. How do I do that? Do I say, don't present these——

Senator LEVIN. You've created some layers beneath you. The regulation is that all you're going to do is sign on the bottom line and you're not going to read what's in the four-page application claim.

Mr. DAWSON. Regulation?

Senator LEVIN. The company. The company practice is that you're going to have someone way down the line look at the whole claim and you're just going to sign the bottom line. You reviewed four departments below you and that's it.

But the purpose of doing that is so you're insulated from any knowledge which would involve you in the claim.

Mr. DAWSON. If the clear purpose is to try to insulate yourself from knowledge, my opinion is that it would be covered under the language of the bill.

Senator LEVIN. I'm not saying knowledge of a false claim; I'm saying knowledge of even an accurate claim.

Mr. DAWSON. But the knowledge that you have that brings you into conscious culpability is the fact that you have insulated yourself to some degree. Now the issue is to what degree does that insulation become liable under this bill? That is a very difficult distinction to draw when you're dealing with 3 feet of statements and claims on a day-to-day basis under a shipbuilding contract, for example.

Senator LEVIN. Your answer, then, is that if you do insulate yourself from that so that you're not culpable under the bill, you're still culpable under the bill?

Mr. DAWSON. The answer is you might be. It will depend greatly upon the facts. And, as I said, these are highly fact-laden issues.

Senator LEVIN. If Mr. Kusserow's revised testimony or if his position is that gross negligence is where the standard should be, placing him at the same point with Mr. Vander Schaaf on the continuum, you would say that that standard is still not tough enough.

Mr. DAWSON. I missed the last part.

Senator LEVIN. Well, you basically don't accept the gross negligence standard, even if that's where Mr. Kusserow is.

Mr. DAWSON. That's correct.

Senator LEVIN. Where are you on the reckless standard?

Mr. DAWSON. Well, one concern that I have with this whole proposition is that under some standards, you don't want to provide a disincentive to the person that signs the claim, or the supervisor, to report violations. You want to make sure that individual is trying to correct the system and that the person is going report violations to his superiors when a situation occurs.

And I could argue that your proposition, as it could be interpreted by agencies, might, indeed, make people unwilling to take on responsibility for these kinds of things because of their fear that they, too, could be punished under a reckless disregard or gross negligence standard. And if I've not made myself clear that we oppose gross negligence or reckless disregard as a standard——

Senator LEVIN. Also, the reckless disregard would also be unacceptable.

Mr. DAWSON. Yes.

Senator LEVIN. The reasons that you——

Mr. DAWSON. That's correct.

Senator LEVIN. I don't want to pursue this much longer because we're all probably getting hungry, but how is the reckless disregard standard different from your objective person being tipped off standard?

Mr. DAWSON. The person that is making this distinction in the agency is going to be trying to apply this law. That person will have difficulty trying to make this really subtle distinction between the two issues.

So, in the first case, I argue that I would tend to go for the one rung higher up the ladder to ensure that you wouldn't be dragging in the merely negligent, as we saw Mr. Kusserow do.

That's one answer.

The second answer is that the person found to be grossly negligent need not have been tipped off or alarmed or on guard as to what may take place. He only had to have taken something beyond inadvertence and have failed to perform a manifest duty, and to disregard the consequences of his action. He didn't have to be put on guard.

Very separate.

Senator LEVIN. You don't require that the person have to be put on guard, either. You only require that an objective or reasonable person be put on guard.

Mr. DAWSON. That is correct.

Senator LEVIN. Not that the person actually be put on guard. I don't understand the difference still between the reckless disregard standard and your objective person being put on guard standard.

You don't accept the reckless disregard standard. You go a notch higher yet on the ladder, which is maybe a fourth notch—you've got negligent, gross negligent, reckless disregard, and then your objective person being tipped off standard. And I don't understand the difference between the third and the fourth notches—the reckless disregard and the objective person being put on guard standard.

Mr. DAWSON. In one case, you could make the distinction on the basis of how much duty to inquire does the individual have. The difficulty with that is you don't want to run afoul of the person being able to insulate himself, either.

So that is one way to distinguish it—does the person have an affirmative duty to inquire altogether? Does the person have an affirmative duty to inquire only if he is tipped off and put on guard as to the fact that might alarm a reasonable man?

That is one way to try to explain that distinction. But, as I said, these are very elusive.

Senator LEVIN. Well, I don't think I ever understood them in law school and I'm not sure I understand them now.

So [laughter.] Mr. Dawson, to you and the other witnesses, and particularly those whose names we mispronounced [laughter.] thank you very much for your help. Good seeing you again.

Mr. DAWSON. Good to see you.

[Mr. Dawson's prepared statement follows:]

PREPARED STATEMENT OF RHETT DAWSON

Mr. Chairman and members of the Committee, I am Rhett Dawson and today I am appearing on behalf of the Aerospace Industries Association of America, Inc., (AIA) the trade association representing the nation's major manufacturers of commercial, military and business aircraft, helicopters, aircraft engines, missiles, spacecraft and related components and equipment. Thank you for giving us the opportunity to comment on this legislation and I ask that my entire statement be included in the record of these hearings.

No responsible citizen or organization can in good conscience oppose the laudable efforts of this Committee to deal with the frustrating problem of fraud perpetrated upon our government. It is plain that such fraud is a wrong that deserves redress. We have examined this bill closely and believe that it does, indeed, address this wrong in a manner that is an improvement upon its predecessors. Nevertheless, we have serious doubts that S. 1134, as it is now drafted, is the vehicle by which that wrong is properly righted. This bill, whose ambit embraces virtually every claim made to or against the government in an amount less than $100,000, sets up an overinclusive and intrusive administrative process of awesome power. The investigatorial, prosecutorial and judicial features of this administrative process pose grave policy questions in that they create a new system of investigation and adjudication that has none of the formal protections that have historically been accorded to civil defendants liable for fines and/or damages. Almost any dealing that a private citizen or corporation has with its government, either directly or through private, local, or state government entities, subjects that citizen or corporation to the investigative whim of the federal agency affected; and the bill further provides for the imposition of draconian penalties for what may have been the most minor of mistakes.

Because the aerospace industry is so heavily involved with the federal government, and because of the extraordinary complexity of the government procurement process and, indeed of the items so procured, the provisions of this bill have special and readily discernible impact upon this industry. Because the bill provides that each voucher, invoice, claim, or other individual request or demand to the federal government for property, services or money and each written representation or certification constitutes a separate claim or statement, whether made, presented, or submitted separately or together with other claims or statements, one procurement or services contract awarded to a firm in the aerospace industry could easily result in thousands of separately punishable claims or statements, each of which is subject to a $10,000 penalty as well as a penalty, in lieu of damages, not more than twice the amount of the claim. The disproportion of such a result is made all the more objectionable by virtue of the fact that all determinations under the provisions of this bill are not made in a court of law, but in an administrative proceeding in which the lowest standard of proof applies and which is subjected to the lowest possible standard of appellate review.

We are primarily concerned with four issues that arise from the provisions of this bill, which, as I have stated, I believe is superior to its predecessor bills, but which nevertheless has serious flaws that require this Committee's careful consideration. First, there appears to be a question about the interpretation of the bill's knowledge standard -- "a claim that the person knows or has reason to know." Certain agencies have construed that phrase in one manner and the common law has traditionally construed it in another. Second, we are persuaded that this bill -- which reaches both $3 and $33,000 frauds -- should provide guidance to agencies on the level of due process and procedural safeguards applicable to those accused of false statements or fraud. The summary treatment available under this bill for a $3 fraud case is not the type of treatment appropriate for or expected by a contractor who may pay over $200,000 in penalties and may face the debarment of his business from the area of government procurement. And neither treatment would give the accused anything approaching the rights they would be normally accorded in a federal court.

Without some legislative guidance on standards and limits to be applied in discovery, on evidentiary rules, on the process that should be due to different levels of alleged fraud, and on objective penalties appropriate for certain categories and levels of claims, this bill will certainly result in constantly differing, subjective determinations by different agencies that produce drastically disparate results from similar facts. Guidance on these questions in the bill itself would vitiate this problem. Third, because the rules and regulations that blanket the government procurement field are labyrinthine at best, we are concerned that contractors, by mere inadvertence, mistake or negligence, may be found guilty of a false claim by failing to comply with regulations of which they were ignorant. Moreover, a minor error of omission in a complex regulatory scheme could well result in a substantial penalty and, possibly, in suspension or debarment. This area, too, needs clarification. Finally, our last major concern derives from S. 1134's provision that hearing examiners are to be employees of the same authority which brings the false claim action, and that they are to be appointed by, and presumably be answerable to, the same authority head who appoints the reviewing official and the investigating official. We believe that where the penalties can be as substantial as under this bill and where the investigator, prosecutor and administrative judge all are appointed by, work for, and answer to the same authority head, who then functions as the sole administrative appellate forum, there is insufficient insulation between actors to assure impartial and fair determinations.

Knowledge

The language of section 802 is quite clear: "Any person who . . . [makes] . . . a claim that the person knows or has reason to know . . . is false, fictitious or fraudulent . . . shall be subject to [the penalties provided]." (emphasis supplied). The common law is plain that "knowledge means conscious belief . . . requir[ing] awareness of a fact or condition." Restatement (Second) of Agency § 9 comment c (1958), Appendix (1984). "'[R]eason to know' imports no duty to ascertain facts not to be deduced as inferences from facts already known; one has reason to know a fact only if a reasonable person in his position would infer such fact from other facts already known to him." Id., comment d; see also Restatement (Second) of Torts § 12(1) (1965); Restatement of Agency § 9 comment c (1933).

We believe that the standard of knowledge in S. 1134 clearly imports a level of conscious culpability -- of intent -- that is the minimum acceptable standard for a statute that provides so substantial a punitive sanction. The courts have regularly followed this interpretation of "knows or has reason to know" and, while we would prefer a stricter one, this standard is a reasonable one to consider if the Committee explicitly embraces its commonly accepted judicial meaning, as described above.

We raise this point to dispel confusion that might arise from other interpretations that might be inserted into the record. In June 1982, Richard Kusserow, Inspector General of HHS, who is also testifying today, wrote, and in November 1983 he submitted, a discussion of the Civil Monetary Penalties Act of 1981 that was inserted into the hearing record of a predecessor bill to S. 1134. That discussion stated that the phrase "has reason to know" does not require a showing of specific intent to deceive or of actual knowledge of falsity. And, in the Federal Register of August 26, 1983, at page 38,831, also inserted into an earlier hearing record, HHS made clear that, in its view, under the knowledge standard "knows or has reason to know" a prosecutor need not show actual knowledge, but simply that the claimant should have known, stating additionally that "[t]he statute sweeps within its ambit not only the knowing, but the negligent, and we are obliged to give it its scope." In light of such radically different interpretations that would lead to radically different results, we believe that the Committe should make plain that the bill follows the consistent common law interpretation of that phrase discussed in the Restatement (Second) of Agency and of Torts.

Guidelines

This bill is designed to treat alleged false statements or false or fraudulent claims for amounts less than $100,000. In the course of any one government contract, hundreds, if not thousands, of statements and claims, as defined by this bill, may be submitted to an "authority." Claims may be made for as little as $1.00 or as much as $99,999, yet this legislation does not distinguish between a false statement with minor impact and a complex fraudulent scheme of major effect.

More seriously, this bill appears to allow the government, at its option, to avoid the strict burdens of proof and procedural safeguards found in the federal courts by breaking into twenty or more component parts a $2 million alleged fraudulent scheme and holding twenty or more separate administrative trials. Those trials can be summary in nature, held under administrative regulations, without the protections of a grand jury, an Article III judge, a petit jury, civil fraud or criminal standards of proof, the Federal Rules of Civil or Criminal Procedure, the Federal Rules of Evidence or substantive appellate review. And, over $4.2 million in penalties can be levied in the proceedings.

The bill inserts a materiality requirement in section 802(a)(2)(B) regarding the omission of a fact from a statement. In principle that requirement is appropriate; as a practical matter in a proceeding, a prosecutor can assert that anything is material, thus reaching whole ranges of representations unmade by contractors and others, yet which subject them to liability.

This bill gives almost unlimited discretion to investigating officials, reviewing officials and hearing examiners. It is the association's position that such unfettered, and essentially unreviewable, discretion at every level of a proceeding is inappropriate in legislation that can result in a substantial penal sanction upon a person or corporation. Guidelines that limit or direct the discretionary action of the appropriate official or hearing examiner are proper at a number of stages. First, because this bill provides open-ended administrative subpoena power to the authority for documents and -- for the first time -- for witnesses, and only allows, subject solely to the hearing examiner's discretion, comparable discovery by the person or corporation accused, guidelines ought to be set in the bill on the discovery that may be requested by the government or by the accused. Plainly, in an administrative process, a $3 fraud case should be treated differently than a $33,000 fraud case, and different levels of due process and discovery should apply. This distinction holds true for a second area in which guidelines are appropriate. While a minimum level of due process is appropriate in any case that may result in a substantial penalty, where the substantial penalty can be significantly greater, and the possibility of suspension or debarment exists, more stringent due process safeguards should be mandated to assure both the existence and appearance of fair play. Third, because this bill applies to every executive department and "establishment which is not an executive department", it would appear likely that the hearing examiners of each different authority would impose penalties differently. Differing penalties based upon the same or similar facts would create disparate results surely not in the contemplation of the drafters of this bill. We suggest that objective penalties for different categories and levels of false statements or claims be incorporated into this bill together with provisions for aggravating or mitigating circumstances that would either increase or decrease the objective penalty depending upon a variety of factors.

The inclusion of such guidelines into this legislation is essential to temper and restrain its extraordinary grants of discretion and administrative power. As this bill now stands, discretion in these important areas is unlimited; it lacks any direction and officials can treat any level of alleged fraud or falsity in the same summary fashion. Rather than create a multi-headed hydra that acts differently in every "authority", this bill can and should contain guidelines to ensure that the government speaks with one voice.

Complexities of Procurement Law

The rules and regulations governing government procurement law for every agency and department of the federal government are byzantine in their complexity and interrelation. The complexities of this field require an army of lawyers to advise, guide, and act for their principals. As noted earlier, we believe it should be made plain that the standard of knowledge required to prove the submission of a false claim is that the person making the claim was consciously aware of its falsity or had reason to know it was false by being able to infer falsity from facts already known to him.

As previously discussed, section 802(a)(2)(B) states that a statement is false if it omits a material fact required to be made, and the statement so made is false or fraudulent as a result of the omission. While recognizing that with regard to a truly material fact this provision may properly apply to many false statements, we are deeply concerned that, in light of the extraordinary complexity of procurement regulations, the innocent or negligent omission of a material fact in one or more of many required documents may subject a contractor to substantial liability under this bill. We believe it should be made explicit that, under the bill, the Committee does not intend to punish omissions which are innocently or mistakenly made.

A further, serious, concern is the interrelation between suspension and debarment regulations and this bill. The provisions of this bill, as they now stand, may readily upset the entire due process framework surrounding suspension and debarment of a government contractor. FAR Sections 9.407-1 and 9.407-2 make plain that suspension is "a serious action to be imposed on the basis of adequate evidence . . . ." Under S. 1134 a finding of probable cause by a reviewing official that a contractor had submitted a false statement, even by omission, may well be sufficient to sustain a suspension, § 802(b)(1)(A), and a judgment under this bill could be authority for debarment. The suspension and debarment regulations were carefully developed to provide for those serious penalties only in cases where they are merited. Passage of this bill in its present form would allow suspension and debarment -- among the most serious punishments for a government contractor -- for the most innocuous of unintentional omissions.

Insulation of the Hearing Examiner from the Authority

This statute provides that the investigating official, reviewing official, hearing examiner, and authority head are all to be employees of the same authority. This, in effect, provides that the investigator, prosecutor, judge, and appellate forum are all in the same agency. With the exception of the authority head, who is the administrative appellate forum, the reviewing official, investigating official, and hearing examiner are all appointed by the same authority head and are presumably answerable to him. This concentration of prosecutorial, judicial and appellate functions among the same group of people working in the same agency raises serious doubts about the impartiality and fairness of the administrative, judicial and appellate process. When the penalties contemplated by statute are as substantial as those in this bill, and when the debarment of a contractor is such a clear possibility, a separation of judicial and prosecutorial powers is warranted to ensure fair and impartial adjudications.

Although an effort is made in the bill to insulate the hearing examiner from the reviewing and investigating officials, we believe that their employment in the same authority and their appointment by and subordinate position to the same authority head makes it seem too much that the same authority is prosecutor, judge, and jury in one. In light of the scope of this bill, which will create a new investigatorial, prosecutorial, and judicial administrative process throughout the federal government, it is perhaps appropriate to consider creating an independent administrative law judiciary specializing in program fraud administrative trials. This may seem a drastic step, but if the ramifications of this bill are carefully considered, it is apparent that a broad new administrative process, with substantial power and impact, is now being created. If such a new process needs to be created to address the problems of program fraud, at the very minimum it should ensure fair, impartial, consistent and just determinations.

Sub-sections 801(b)(1)-(3), (c)(1)-(2)

These sub-sections of the bill allow almost any type of representation, claim or statement made either to an instrumentality of the federal government, its agent, fiscal intermediary, or other entity acting on its behalf, to serve as the predicate for an administrative investigation and proceeding which may result in substantial, and entirely unexpected, penalties. To the aerospace industry, which generally knows when it deals with the federal government, these provisions of agency in sections 801(b)(3) and (c)(2) are not especially onerous; but to every other American who has regular dealings with our government, not by choice, but because it is ubiquitous in our society and the marketplace, they signal a major and unheralded increase in the intrusion of the federal government into their lives.

One clearly knows the consequences of dealing with the neighborhood bank or with the town councilmen, but can one also fairly expect from such dealings the appearance of an Inspector General of a federal agency and the service of subpoenas duces tecum and to appear for oral deposition? Can one fairly expect that an administrative trial will result in which double the amount of -- let us say -- the mortgage asked for plus a $10,000 fine will be assessed as penalties? These provisions of agency in the statute certainly allow a penalty to reach every fraud that may have any impact upon the federal government, no matter how slight, but it is also plain that penalties may accrue and be imposed in situations that are not presently contemplated and to which they are inappropriate, if not patently unfair.

This bill would allow the Treasury Department and the Internal Revenue Service to set up their own judicial system for false statements or claims made in income tax returns. This bill would there provide for a penalty of double the false claims and a $10,000 fine for each false statement in a return. Is this displacement of the U.S. Tax Court and District Courts really contemplated?

Could every federal employee who files a health insurance claim with Blue Cross/Blue Shield or other insurance company (which provide insurance under contract with the Office of Personnel Management) be subject to administrative investigation and prosecution for an omission or false statement on his or her claim form?

Does every loan application to a federally insured bank, every bid or employment application for every federally underwritten state project, every research grant proposal, every driver's license application to a state that accepts federal highway funds, mean that the federal government may subject those people to unlimited investigation, prosecution in an administrative proceeding -- without the rights they would have in a civil or criminal trial -- and fine them $10,000 for every false statement they made plus double the amount of any false claim?

These concerns of notice, due process, and appropriateness of penalty are highly relevant to the government contractors of the aerospace industry. The field of government procurement is, as we have described, a complicated and esoteric one. Thousands of government officials and thousands of corporate employees deal with the intricacies of government contracts on a daily basis. The number of claims, statements, vouchers, forms, certificates and representations of all types tendered with respect to one major -- or minor -- government contract is, without hyperbole, staggering. The number of disputes, major and minor, that arise from these contracts is equally staggering. There is a sophisticated and constantly functioning mechanism in use to resolve all such disputes.

Disputes in this area arise when a contractor, who fairly believes he is entitled to a certain payment for a service or product, confronts a government servant who believes, with equal vigor, that he is not so entitled. Many of these disputes give rise to much rancor and bitterness on both sides, and many are fairly resolved by either negotiated settlement or resort to the dispute resolution mechanisms that exist. In the area of government contracts, the government's specialists are, as appropriate, hard-nosed bargainers and examiners of contract proposals and contractors' claims. This bill, however, takes this contracting process -- which has been long evolving -- and superimposes upon it an administrative process that renders much of it immaterial and disrupts the remainder.

The provisions of this bill allow any error, no matter how insignificant in amount or how unrelated to an entire contract, to cause the initiation of an administrative investigation that is unlimited in its scope and that can discover every secret and negotiating tactic possessed by an adversary. Merely as a practical matter, this provision of the bill is objectionable, for what contractor -- before he negotiates his next contract -- will be able to negotiate from the same position when he knows that his entire business has been minutely scrutinized by the very people with whom he must negotiate.

More to the point is the concern that this bill shifts bargaining leverage, particularly unfair leverage, into the hands of the contracting agency. As noted earlier, the government does not lack hard bargainers, and it also does not lack hard bargainers who, in the heat of negotiation or later, may take unfair advantage of the power this bill gives them. The threat of an adminstrative trial on either inadvertent errors or on claims believed to be justified but questioned by the agency -- together with the plain and terrifying possibility (to a government contractor) of an adverse finding resulting in suspension and debarment -- may easily be sufficient cause for a contractor to compromise its rights by a settlement that places it at contractual disadvantage. Our government, while it has always condemned and prosecuted fraud, has also always subscribed to concepts of fair play. As it now stands, this legislation fundamentally changes the government procurement process by giving an advantage to agencies that can now both negotiate with and prosecute the same government contractor.

Conclusion

If this bill is warranted by substantial problems of program fraud that are not addressed by the Department of

Justice, it is our firm belief that it should be amended to resolve the concerns and problems we have raised. The creation of a new investigatorial and judicial administrative process with the power to levy substantial penalties is a serious matter. It should be undertaken only after serious deliberation of its many effects to make it as just and fair as our traditions demand. I thank the Committee for having given me this opportunity to communicate the views of the Aerospace Industries Association of America and I am available for any questions the Committee might have of me.

Senator LEVIN. The subcommittee is now in recess.

[Whereupon, at 12:25 p.m., the subcommittee was recessed to reconvene at the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

99TH CONGRESS
1ST SESSION

S. 1134

To amend title 5, United States Code, to provide administrative civil penalties for false claims and statements made to the United States by certain recipients of property, services, or money from the United States, by parties to contracts with the United States, or by Federal employees, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MAY 15 (legislative day, APRIL 15), 1985

Mr. COHEN (for himself, Mr. ROTH, Mr. NUNN, Mr. LEVIN, and Mr. CHILES) introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

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A BILL

To amend title 5, United States Code, to provide administrative civil penalties for false claims and statements made to the United States by certain recipients of property, services, or money from the United States, by parties to contracts with the United States, or by Federal employees, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Program Fraud Civil Penalties Act of 1985".

SEC. 2. (a) The Congress finds that—

(1) false, fictitious, and fraudulent claims and statements in Government programs are a serious problem;

(2) false, fictitious, and fraudulent claims and statements in Government programs result in the loss of millions of dollars annually by allowing ineligible persons to receive Federal funds to which they are not entitled;

(3) false, fictitious, and fraudulent claims and statements in Government programs undermine the integrity of such programs by allowing ineligible persons to participate in such programs; and

(4) present civil and criminal remedies for such claims and statements are not sufficiently responsive.

(b) The purposes of this Act are—

(1) to provide Federal agencies which are the victims of false, fictitious, and fraudulent claims and statements with an administrative remedy to recompense such agencies for losses resulting from such claims and statements, to penalize persons who make, present, or submit such claims and statements, and to deter the making, presenting, and submitting of such claims and statements in the future; and

(2) to provide due process protections to all persons who are subject to the adjudication of administra-

tive penalties for false, fictitious, or fraudulent claims or statements.

Sec. 3. (a) Title 5, United States Code, is amended by inserting after chapter 7 the following new chapter:

"CHAPTER 8—ADMINISTRATIVE PENALTIES AND ASSESSMENTS FOR FALSE CLAIMS AND STATEMENTS

"Sec.

"801. Definitions.
"802. False claims and statements; liability.
"803. Hearing and determinations.
"804. Subpena authority.
"805. Judicial review.
"806. Collection of civil penalties and assessments.
"807. Limitations.
"808. Regulations.
"809. Reports.

"§ 801. Definitions

"(a) For purposes of this chapter—

"(1) 'authority' means—

"(A) an executive department;

"(B) an establishment (as such term is defined in section 11(2) of the Inspector General Act of 1978) which is not an executive department; and

"(C) the United States Postal Service;

"(2) 'authority head' means—

"(A) the head of an authority; or

"(B) an official or employee of the authority designated, in regulations promulgated by the head of the authority, to act on behalf of the head of the authority;

"(3) 'claim' means any request or demand—

"(A) made to an authority for property, services, or money (including money representing grants, loans, insurance, or benefits); or

"(B) made to a recipient of property, services, or money from an authority or to a party to a contract with an authority—

"(i) for property or services if the United States—

"(I) provided such property or services;

"(II) provided any portion of the funds for the purchase of such property or services; or

"(III) will reimburse such recipient or party for the purchase of such property or services; or

"(ii) for the payment of money (including money representing grants, loans, insurance, or benefits) if the United States—

"(I) provided any portion of the money requested or demanded; or

"(II) will reimburse such recipient for any portion of the money paid on such request or demand;

"(4) 'statement' includes any written representation, certification, document, record, or accounting or bookkeeping entry—

"(A) with respect to a claim; or

"(B) with respect to—

"(i) a contract with, or a bid or proposal for a contract with;

"(ii) a grant, loan, or benefit from;

"(iii) an application for insurance from; or

"(iv) an application for employment with,

an authority, or any State, political subdivision of a State, or other party acting on behalf of, or based upon the credit or guarantee of, an authority;

"(5) 'person' means any individual, partnership, corporation, association, or private organization;

"(6) 'investigating official' means—

"(A) in the case of an authority in which an Office of Inspector General is established by the Inspector General Act of 1978 or by any other

Federal law, the Inspector General of that authority; or

"(B) in the case of an authority in which an Office of Inspector General is not established by the Inspector General Act of 1978 or by any other Federal law, any officer or employee of the authority designated by the authority head to conduct investigations under section 803(a)(1) of this title;

"(7) 'reviewing official' means any officer or employee of an authority—

"(A) who is designated by the authority head to make the determination required under section 803(a)(2) of this title; and

"(B) who, if a member of the armed forces on active duty, is serving in grade O–7 or above or, if a civilian, is serving in a position for which the rate of basic pay is not less than the minimum rate of basic pay for grade GS–16 or above under the General Schedule; and

"(8) 'hearing examiner' means any officer or employee of an authority—

"(A) who is appointed by the authority head in the same manner as administrative law judges are appointed pursuant to section 3105 of this title; and

"(B) who, if a member of the armed forces on active duty, is serving in grade O-7 or above or, if a civilian, is serving in a position for which the rate of basic pay is not less than the minimum rate of basic pay for grade GS-16 or above under the General Schedule.

"(b) For purposes of paragraph (3) of subsection (a)—

"(1) each voucher, invoice, claim form, or other individual request or demand for property, services, or money constitutes a separate claim whether made, presented, or submitted separately or together with other claims;

"(2) each request or demand for property, services, or money constitutes a claim regardless of whether such property, services, or money is actually delivered or paid; and

"(3) a claim shall be considered made, presented, or submitted to an authority, recipient, or party when such claim is made to an agent, fiscal intermediary, or other entity, including any State or political subdivision thereof, acting for or on behalf of such authority, recipient, or party.

"(c) For purposes of paragraph (4) of subsection (a)—

"(1) each written representation or certification constitutes a separate statement whether made, presented, or submitted separately or together with other statements; and

"(2) a statement shall be considered made, presented, or submitted to an authority although such statement is actually made to an agent, fiscal intermediary, or other entity, including any State or political subdivision thereof, acting for or on behalf of such authority.

"§ 802. False claims and statements; liability

"(a)(1) Any person who, on or after the effective date of this chapter, makes, presents, or submits, or causes to be made, presented, or submitted, a claim that the person knows or has reason to know—

"(A) is false, fictitious, or fraudulent;

"(B) includes or is supported by any statement which violates paragraph (2) of this subsection; or

"(C) is for payment for the provision of property or services which the person has not provided as claimed,

shall be subject to, in addition to any other penalty that may be prescribed by law, a civil penalty of not more than $10,000 for each such claim. Such person shall also be subject to an assessment, in lieu of damages sustained by the

United States because of such claim, of not more than twice the amount of such claim.

"(2) Any person who, on or after the effective date of this chapter, makes, presents, or submits, or causes to be made, presented, or submitted, a statement that the person knows or has reason to know—

"(A) asserts a material fact which is false, fictitious, or fraudulent; or

"(B)(i) omits a material fact,

"(ii) as a result of such omission, such statement is false, fictitious, or fraudulent, and

"(iii) the person making, presenting, or submitting such statement has a duty to include such material fact in the statement,

shall be subject to, in addition to any other penalty that may be prescribed by law, a civil penalty of not more than $10,000 for each such statement. In the case of a statement relating to a claim for money, such person shall also be subject to an assessment, in lieu of damages sustained by the United States because of such statement, of not more than twice the amount of such claim.

"(b)(1) Except as provided in paragraph (2) of this subsection, a determination of—

"(A) probable cause that a person is liable under section 803(a)(2) of this title, or

"(B) liability under section 803 of this title,

may provide the authority with grounds for commencing any administrative or contractual action against such person which is authorized by law and which is in addition to any action against such person under this chapter.

"(2) A determination referred to in paragraph (1) of this subsection may be used by the authority, but shall not require such authority, to commence any administrative or contractual action which is authorized by law.

"§ 803. Hearing and determinations

"(a)(1) The investigating official of an authority may investigate allegations that a person is liable under section 802 of this title and shall report the findings and conclusions of such investigation to the reviewing official of the authority.

"(2) If the reviewing official of an authority determines, based upon the report of the investigating official under paragraph (1) of this subsection, that there is probable cause to believe that a person is liable under section 802 of this title, the reviewing official may, in accordance with the provisions of subsections (b) and (c) of this section, refer the allegations of such liability to a hearing examiner of such authority for a hearing.

"(b)(1) Prior to referring allegations of liability to a hearing examiner under paragraph (1) of subsection (a), the reviewing official of an authority shall transmit to the Attorney General a written notice of the intention of such official to refer such allegations and a statement of the reasons for such intention.

"(2) A reviewing official may refer allegations of liability to a hearing examiner under paragraph (1) of subsection (a) if—

"(A) the Attorney General or an Assistant Attorney General designated by the Attorney General approves the referral of such allegations; or

"(B) the Attorney General or an Assistant Attorney General designated by the Attorney General takes no action to disapprove the referral of such allegations within—

"(i) ninety days after the date on which the Attorney General receives the notice required by paragraph (1) of this subsection; or

"(ii) such period as may be provided in a memorandum of understanding entered into by the authority head and the Attorney General with respect to such allegations.

"(3) A reviewing official shall not refer allegations to a hearing examiner under paragraph (1) of subsection (a) if the Attorney General or an Assistant Attorney General designated by the Attorney General transmits a written statement to the reviewing official which specifies that the Attorney General or such Assistant Attorney General disapproves the referral of such allegations and states the reasons for such disapproval.

"(4) If the Attorney General or an Assistant Attorney General designated by the Attorney General transmits to an authority head a written finding that the continuation of any hearing under section 803 of this title may adversely affect any pending or potential criminal or civil action related to an alleged false, fictitious, or fraudulent claim or statement under consideration in such hearing, such hearing shall be immediately stayed and may be resumed only upon written authorization of the Attorney General.

"(c) No allegations of liability under section 802 of this title with respect to any claim or statement, made, presented, or submitted by any person shall be referred to a hearing examiner under paragraph (1) of subsection (a) if the reviewing official determines that the amount of money or the value of property or services falsely, fictitiously, or fraudulently requested or demanded in such claim or statement exceeds $100,000.

"(d) A reviewing official shall commence a hearing under subsection (e) of this section by mailing by registered or certified mail, or by delivery, of a notice which complies with the provisions of paragraph (2)(A) of subsection (f) to the person alleged to be liable under section 802 of this title.

"(e) The hearing examiner shall conduct a hearing on the record regarding any allegation referred to the hearing examiner by the reviewing official pursuant to subsection (a) of this section to determine—

"(1) the liability of a person under section 802 of this title; and

"(2) the amount of any penalty and assessment to be imposed on such person.

Any such determination shall be based on the preponderance of the evidence.

"(f)(1) Each hearing under subsection (e) of this section shall be conducted in accordance with—

"(A) the provisions of subchapter II of chapter 5 of this title (to the extent that such provisions are not inconsistent with the provisions of this chapter); or

"(B) procedures promulgated by the authority head under paragraph (2) of this subsection.

"(2) An authority head shall by regulation promulgate procedures for the conduct of hearings under this chapter. Such procedures shall include:

"(A) The provision of written notice of the hearing to any person alleged to be liable under section 802 of this title, including written notice of—

"(i) the time, place, and nature of the hearing;

"(ii) the legal authority and jurisdiction under which the hearing is to be held;

"(iii) the matters of facts and law to be asserted; and

"(iv) a description of the procedures for the conduct of hearing established under this paragraph or established under subchapter II of chapter 5 of this title, as the case may be.

"(B) The provision to any person alleged to be liable under section 802 of this title of opportunities for the submission of facts, arguments, offers of settlement, or proposals of adjustment when time, the nature of the hearing, and the public interest permit.

"(C) Procedures to ensure that the hearing examiner shall not, except to the extent required for the disposition of ex parte matters as authorized by law—

"(i) consult a person or party on a fact in issue, unless on notice and opportunity for all parties to the hearing to participate; or

"(ii) be responsible to or subject to the supervision or direction of the investigating official or the reviewing official.

"(D) Procedures to ensure that the investigating official and the reviewing official do not participate or advise in the decision required under subsection (g) of this section or the review of the decision by the authority head under subsection (h) of this section, except as provided in subsection (i) of this section.

"(E) The provision to any person alleged to be liable under section 802 of this title of opportunities to present such person's case through oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts.

"(F) Procedures to permit discovery by any person alleged to be liable under section 802 of this title only to the extent that the hearing examiner determines that such discovery is necessary for the expeditious, fair, and reasonable consideration of the issues.

"(G) Procedures to permit any person alleged to be liable under section 802 of this title to be accompanied, represented, and advised by counsel or such other qualified representative as the authority head may specify in such regulations.

"(H) Procedures to ensure that the hearing is conducted in an impartial manner, including procedures to—

"(i) permit the hearing examiner to at any time disqualify himself;

"(ii) permit the filing, in good faith, of a timely and sufficient affidavit of personal bias or other disqualification of a hearing examiner or reviewing official; and

"(iii) provide for the determination by the authority head of a matter filed pursuant to clause (ii) of this subparagraph as a part of the record and decision in the hearing.

"(g) The hearing examiner shall issue a written decision, including findings and determinations, after the conclusion of the hearing. The hearing examiner shall promptly send to each party to the hearing a copy of such decision and a statement describing the right of any person determined to be liable under section 802 of this title to appeal the decision of the hearing examiner to the authority head under paragraph (2) of subsection (h).

"(h)(1) Except as provided in paragraph (2) of this subsection and section 805 of this title, the decision, including the findings and determinations, of the hearing examiner issued under subsection (g) of this section are final.

"(2) Within thirty days after the hearing examiner issues a decision under subsection (g) of this section, any person determined in such decision to be liable under section 802 of this title may appeal such decision to the authority head. The authority head may affirm, reduce, compromise, remand, or settle any penalty and assessment determined by the hearing examiner pursuant to this section. The authority head shall promptly send to each party to the appeal a copy of the decision of the authority head and a statement describing the right of any person determined to be liable under section 802 of this title to judicial review under section 805 of this title.

"(i) The reviewing official has the exclusive authority to compromise or settle any allegations of liability under section 802 of this title against a person without the consent of the hearing examiner at any time prior to the date in which the hearing examiner issues a decision under subsection (g) of this section. Any such compromise or settlement shall be in writing.

"§ 804. Subpena authority

"(a) For the purposes of an investigation under section 803(a) of this title, an investigating official is authorized—

"(1) to administer oaths or affirmations;

"(2) to require by subpena the production of all information, documents, reports, answers, records, accounts, papers, and data not otherwise reasonably available to the authority; or

"(3) after notifying the Attorney General, to require by subpena the attendance and testimony of witnesses necessary to the conduct of such investigation.

"(b) For the purposes of conducting a hearing under section 803(e) of this title, a hearing examiner is authorized—

"(1) to administer oaths or affirmations; and

"(2) to require by subpena the attendance and testimony of witnesses and the production of all information, documents, reports, answers, records, accounts, papers, and other data and documentary evidence which the hearing examiner considers relevant and material to the hearing.

"(c) In the case of contumacy or refusal to obey a subpena issued pursuant to subsection (a) or (b) of this section, an investigating official or a hearing examiner, as the case may be, may invoke the aid of any district court of the United States in the district in which such investigation or hearing is being conducted, or where the person receiving the subpena resides or conducts business. The district courts of the United States shall have jurisdiction to issue an appropriate order for the enforcement of any such subpena. Any failure to obey such order of the court is punishable by such court as contempt.

"§ 805. Judicial review

"(a) Unless a petition is filed under this section, a determination of liability under section 803 of this title shall be final and shall not be subject to judicial review.

"(b)(1) Any person for whom a determination of liability under section 802 of this title has been made pursuant to section 803 of this title may obtain review of such determination in the United States Court of Appeals for the circuit in which such person resides or in which the claim or statement upon which the determination of liability is based was made, presented, or submitted, or in the United States Court of Appeals for the District of Columbia Circuit. Such review may be obtained by filing in any such court a written petition that such determination be modified or set aside. Such petition shall be filed—

"(A) only after such person has exhausted all administrative remedies under this chapter; and

"(B) within sixty days after the date on which the authority head sends such person a copy of the decision of such authority head under section 803(h)(2) of this title.

"(2) The clerk of the court shall transmit a copy of a petition filed under paragraph (1) of this subsection to the authority head and to the Attorney General. Upon receipt of the copy of such petition, the authority head shall transmit to the Attorney General the record in the proceeding resulting in the determination of liability under section 802 of this title. Except as otherwise provided in this section, the courts of appeals of the United States shall have jurisdiction to review the decision, findings, and determinations in issue and to affirm, modify, remand for further consideration, or set aside, in whole or in part, the decision, findings, and determinations of the hearing examiner, and to enforce such decision, findings, and determinations to the extent that such decision, findings, and determinations are affirmed or modified.

"(c) The findings of the hearing examiner with respect to questions of fact, if supported by substantial evidence on the record considered as a whole, shall be conclusive.

"(d) Any court of appeals reviewing under this section the decision, findings, and determinations of a hearing examiner shall not consider any objection that was not raised in the hearing conducted pursuant to section 803(e) of this title unless a demonstration is made of extraordinary circumstances causing the failure to raise the objection. If any party demonstrates to the satisfaction of the court that additional evidence not presented at such hearing is material and that there were reasonable grounds for the failure to present such evidence at such hearing, the court shall remand the matter to the hearing examiner for consideration of such additional evidence.

"(e) Upon a final determination by the court of appeals that a person is liable under section 802 of this title, the court shall enter a final judgment for the appropriate amount in favor of the United States, and such judgment may be recorded and enforced by the Attorney General to the same extent and in the same manner as a judgment entered by any United States district court.

"§ 806. Collection of civil penalties and assessments

"(a) The Attorney General shall be responsible for judicial enforcement of any civil penalty or assessment imposed pursuant to the provisions of this chapter.

"(b) Any penalty or assessment imposed in a determination which has become final pursuant to section 803 of this title may be recovered in a civil action brought by the Attorney General. In any such action, no matter that was raised or that could have been raised in a hearing conducted under section 803(e) of this title or pursuant to judicial review under section 805 of this title may be raised as a defense, and the determination of liability and the determination of amounts of penalties and assessments shall not be subject to review.

"(c) The district courts of the United States and of any territory or possession of the United States shall have jurisdiction of any action commenced by the United States under subsection (b) of this section.

"(d) Any action under subsection (b) of this section may, without regard to venue requirements, be joined and consolidated with or asserted as a counterclaim, cross-claim, or setoff by the United States in any other civil action which includes as parties the United States and the person against whom such action may be brought.

"(e)(1) The United States Claims Court shall have jurisdiction of any action under subsection (b) of this section to recover any penalty and assessment if the cause of action is asserted by the United States as a counterclaim in a matter pending in such court. The United States may join as additional parties in such counterclaim all persons who may be jointly and severally liable with the person against whom such counterclaim is asserted.

"(2) No cross-claims or third-party claims not otherwise within the jurisdiction of the United States Claims Court shall be asserted among additional parties joined under paragraph (1) of this subsection.

"(f) The Attorney General shall have exclusive authority to compromise or settle any penalty and assessment the determination of which is the subject of a pending petition pursuant to section 805 of this title or a pending action to recover such penalty or assessment pursuant to this section.

"(g) Any amount of penalty and assessment collected under this chapter shall be deposited as miscellaneous receipts in the Treasury of the United States.

"§ 807. Limitations

"(a) No claim or statement alleged to be a false, fictitious, or fraudulent claim or statement shall be subject to liability under section 802 of this title at any time after six years after the date on which such claim or statement is made, presented, or submitted.

"(b) A civil action to recover a penalty and assessment under section 806 of this title shall be commenced within three years after the date on which the determination of liability for such penalty and assessment becomes final.

"(c) If at any time during the course of proceedings brought pursuant to this chapter the authority head receives or discovers any specific information regarding bribery, gratuities, conflict of interest, or other corruption or similar activity in relation to a false claim or statement, the authority head shall immediately report such information to the Attorney General, and in the case of an authority in which an Office of Inspector General is established by the Inspector General Act of 1978 or by any other Federal law, to the Inspector General of that authority.

"§ 808. Regulations

"(a) Each authority head shall promulgate rules and regulations necessary to implement the provisions of this chapter. Such rules and regulations shall insure that investigating officials are not responsible for conducting the hearing required in section 803(e) of this title, making the determinations required by subsections (e) and (g) of section 803 of this title, or making the collections under section 806 of this title.

"(b) The Attorney General may enter into a memorandum of understanding with the head of any authority to provide expeditious procedures for approving or disapproving the referral of allegations under section 803(b) of this title and for referral of matters for action under sections 805, 806, and 807(d) of this title. Such memorandum of understanding may provide advanced authorization to refer allegations under section 803(b) of this title with respect to any particular type or class of alleged false claims or statements if not otherwise barred by section 807 of this title.

"§ 809. Reports

"(a) Not later than October 31 of each year, each investigating official shall prepare and transmit to the authority head an annual report summarizing actions taken under this chapter during the most recent twelve-month period ending the previous September 30. Such report shall include—

"(1) a summary of matters referred to the reviewing official under section 803(a)(2) of this title during such period;

"(2) a summary of matters transmitted to the Attorney General under section 803(b)(1) of this title during such period;

"(3) a summary of all hearings conducted by hearing examiners under section 803(e) of this title, and the results of such hearings, during such period; and

"(4) a summary of the actions taken during such period to collect any civil penalty or assessment imposed under this chapter.

"(b) The authority head shall transmit each report received under subsection (a) of this section to the appropriate committees and subcommittees of Congress in the same manner as the reports of Inspectors General are transmitted under section 5(b) of the Inspector General Act of 1978 on October 31 of each year.".

(b) The table of chapters for part I of title 5, United States Code, is amended by inserting after the item relating to chapter 7 the following new item:

"8. Administrative Penalties and Assessments for False Claims and Statements.. 801.".

Sec. 4. (a) Except as provided in subsection (b), this Act and the amendments made by this Act shall take effect 180 days after the date of enactment of this Act.

(b) Section 808(a) of title 5, United States Code (as added by section 3(a) of this Act) shall take effect on the date of enactment of this Act. Regulations required to be promulgated under such section 808(a) shall take effect 180 days after the date of enactment of this Act.

U.S. Department of Justice

Civil Division

Office of the Assistant Attorney General
Washington, D.C. 20530

August 2, 1985

Senator William Cohen
Chairman
Subcommittee on Oversight
of Government Management
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This is in response to several questions raised by Senator Carl Levin at the Subcommittee's June 18, 1985 hearing on S. 1134.

Our research has not uncovered any current laws which permit a non-ALJ administrative hearing examiner to assess civil forfeitures. However, S. 1128, the Clean Water Act Amendments as passed by the Senate, permits the administrator of EPA to assess a civil money penalty without providing any of the APA protections contained in sections 554 and 556 of Title 5. Nor is it required that the penalty be assessed by an ALJ.

Secondly, with respect to the question of whether the hearing examiners contemplated by S. 1134 need be lawyers, once again, we could find no cases directly in point. However, many small claims court judges are not lawyers and the three-member Boards of Veterans' Appeals which decide medical questions are composed of doctors, as well as lawyers. Parole Commission hearing officers may also be non-lawyers. In fact, nothing in the Constitution or federal law requires that Article III judges, including Supreme Court Justices, be members of the bar.

Third, as was noted during the hearing, absent a conforming change in the $2,000 forfeiture penalty of the False Claims Act, there will be an inconsistency with the $10,000 forfeiture contained in S. 1134. As I noted at the hearing, we urge the Congress to set both penalties at $5,000 -- a level which we believe would be reasonable.

Nevertheless, we do not believe that the failure to make a conforming change in the False Claims Act would subject S. 1134 to successful constitutional challenge on equal protection grounds. In the first place, there is no suspect classification, such as race or sex, which might mandate a higher level of scrutiny by the courts. Many statutes contain different penalty levels for varying degrees of conduct, and these have withstood constitutional challenges.

Moreover, although we do not advocate retaining different forfeiture levels, a rational basis for such a distinction could be ascertained by the courts. Because a smaller fraud case will usually require nearly as many resources as a larger case, a larger forfeiture may be appropriate in order to ensure that the government fully recovers its costs of investigation and prosecution from the guilty party.

Finally, the Department of Justice has been asked to provide some further analysis of the knowledge requirement which serves as a threshold to liability under the Program Fraud Civil Penalties Act of 1985.

As we understand the Subcommittee's concern, it is to craft a legal standard which will impute knowledge to a person for gross negligence in the preparation and submission of inaccurate information to the government, while distinguishing and excluding from liability inaccuracies which result from mere negligence, accident, or inadvertence. Thus, a person's disregard for facts which are known or readily discoverable upon reasonable inquiry should result in liability, in our view. So, too, should conduct which reflects ignorance by design -- the "ostrich" problem, wherein a person insulates himself or herself from knowledge which would contradict the representations which that person makes to the government.

At the same time, government regulations and standards of eligibility are often complex and the persons seeking such benefits are sometimes unsophisticated. There are opportunities for honest confusion, mistakes do occur, and wrong information may be submitted inadvertently. We agree that such instances should not be treated as false claims under the proposed Act.

The first safeguard against the punishment of accidental misstatements is the requirement in the bill that some modicum of knowledge be proved. That an act be done "knowingly" has traditionally been construed by the judiciary to exclude conduct which is the product of mistake, accident or other innocent reason. This important feature of the bill establishes a general minimum threshold upon which questions of liability must be determined.

At the Subcommittee hearing on June 18, 1985, one witness testified regarding the language currently proposed, which proscribes the submission of statements or claims which a person "knows or has reason to know" are false. Quoting from the

Restatement of Agency, 2d, § 9, this witness urged a construction of "reason to know" which, "imports no duty to ascertain facts not to be deduced as inferences from facts already known; one has reason to know a fact only if a reasonable person in his position would infer such fact from other facts already known to him." (Statement of Rhett Dawson, p. 6).

This construction is not acceptable and should be rejected. It imports no duty to inquire or investigate to assure that representations are accurate, unless the existence of a contradicting fact could reasonably be inferred from other facts already known. This standard encourages a passive approach to the submission of data to the government: the less known, the easier it is to make a representation without responsibility for its accuracy.

A second approach concerns the adoption of a gross negligence standard, which the Subcommittee has also heard discussed. This concept embraces carelessness in the extreme or a reckless disregard for the truth or falsity of the representation made. This concept distinguishes between mere negligence, which should not be punished, and deliberate intent to defraud, which the government should not be required to prove. Thus, it is a reasonable middle ground.

The foundation of this concept lies in the premise that a party seeking government business or benefits has an obvious responsibility to advise the government of the true and accurate basis of his application. Within the scope of this responsibility is a duty to be informed of the basic requirements of eligibility and standards of participation. United States v. Cooperative Grain & Supply Co., 476 F.2d at 55. This obligation to inquire extends both to the criteria which the government sets for participation and to the compilation of facts which demonstrate compliance with that criteria.

In this regard, we have been provided by the Subcommittee's staff with proposed language which we understand will be considered during mark-up. This language would define "knows or has reason to know" as (A) actual knowledge or (B) "constructive knowledge of the fact which the person would have learned upon making such inquiry as would be reasonable and prudent to conduct under the circumstances." This proposal has several beneficial aspects.

First, it follows very closely the pattern jury instruction which judges use to instruct lay jury members regarding what the law has traditionally required as a basis for finding constructive knowledge. 2 E. Devitt & C. Blackmar, Federal Jury Practice and Instructions § 72.06 (3d ed. 1977). Thus, if added to the statute, it would represent a simple, succinct, and understandable statement of the standard which will determine liability. Moreover, by enacting this language the Senate would not be injecting another new, or possibly different, legal standard to address the general subject of scienter; instead, the Senate would be adopting a time-tested and familiar one.

Second, the standard has flexibility. While recognizing a duty to inquire concerning both the criteria for participation in a federal program and the facts available to the applicant which bear on that eligibility, the duty is pointedly qualified to that inquiry which is reasonable under the circumstances. This standard takes into account the clarity of the applicable regulations, the relative sophistication and resources of the citizen, the burdensomeness or ease of the inquiry, the amount of time available, the costs involved, and like considerations. A low-income individual applying for a student loan or for a HUD-insured mortgage, for instance, may be held to a different obligation than an established government contractor that certifies its cost submissions as accurate, complete and current. The benefit of adopting this standard, consequently, is that it allows determinations of liability to be tailored to the program. A person alleged to be liable under this Act will be judged according to the general conduct of others participating in the same program. The Act thus obtains a much more accurate sense of peer group conduct from which to evaluate the reasonableness of an accused's conduct than would ever be available to a jury sitting in judgment of a single case.

Finally, the proposed language allows an accused to erect a defense to fraud charges based upon the most minimal of showings. All that need be proven is that a reasonable inquiry was conducted under the circumstances. Once this is done, liability based upon a theory of constructive knowledge is defeated.

Sincerely,

Richard K. Willard

RICHARD K. WILLARD
Acting Assistant Attorney General

DEPARTMENT OF HEALTH & HUMAN SERVICES
Office of Inspector General
Washington, D.C. 20201

1985 AUG 21 PM 10:07

The Honorable William S. Cohen
Chairman, Subcommittee on Oversight of
  Government Management
Committee on Government Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In response to questions posed at the hearing before the Subcommittee on June 18, 1985, we agreed to furnish a copy of the final rules governing civil monetary penalties proceedings at the Department of Health and Human Services, and to provide certain information relating to the decision to use administrative law judges (ALJ's) attached to the Departmental Grant Appeals Board to conduct civil monetary penalty hearings. It is my pleasure to assist you in your consideration of this important legislation.

I have enclosed a copy of the final rules, 45 C.F.R. Part 101, including the preamble to the rulemaking which discusses the public comments received with respect to the rules. (Vol. 48 Fed. Reg. 38827 (Aug. 26, 1983)). Our decision to use ALJ's was dictated by the legal requirements of the Administrative Procedure Act at 5 U.S.C. §§ 554, 556. This issue is discussed in the enclosed preamble to the rules, at pages 38833-38834.

In 1982 an informal task force within the Department, consisting of the Assistant Secretary for Management and Budget, the General Counsel, the Inspector General, and the Administrator of the Health Care Financing Administration, considered the issue of what organization in the Department should be responsible for the ALJ's appointed to hear civil monetary penalty cases. While the task force rendered no formal report, it was decided to place the ALJ's under the aegis of the Departmental Grant Appeals Board, an entity with five Board Members appointed by the Secretary. The Grant Appeals Board (GAB) is primarily responsible for adjudicating disputes pertaining to Department grants to States and other organizations, such as Medicaid and Aid to Families with Dependent Children grants to States, and Public Health Service grants. The Chairman of the GAB reports directly to the Under Secretary. The Board itself plays no role in civil monetary penalty hearings, however, any ALJ's assigned to this duty are the Board's responsibility.

The main alternative to the GAB which was considered was the Office of Hearings and Appeals of the Social Security Administration, since it is already staffed with approximately 850 ALJ's. However, it was thought preferable to create a special unit of ALJ's for civil monetary penalty hearings, where the judges would not be burdened by other responsibilities. The hearings would not compete for a place on backlogged dockets, and a special unit of ALJ's could acquire substantial expertise in the subject matter and better insure consistency of decisions. In addition, the Office of Hearings and Appeals is a part of the Social Security Administration, one of the Department's operating divisions. The Grant Appeals Board was chosen because it is a centralized authority which is not organizationally related to the major operating division of the Department. This factor would provide for substantial independence from all organizations with a potential interest in civil monetary penalty litigation. Finally, since the GAB serves the entire Department, we believed it was an appropriate choice for the ALJ's, because the ALJ staff could be expanded if legislation were enacted to provide civil money penalty authority for other programs of the Department.

If I can furnish any other information which would be useful in your consideration of S. 1134, please contact me.

Sincerely yours,

Richard P. Kusserow
Inspector General

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of the Secretary

45 CFR Part 101

Medicare, Medicaid, and Maternal and Child Health Services Block Grant Programs; Civil Money Penalties and Assessments for False or Improper Claims

AGENCY: Department of Health and Human Services.

ACTION: Final rule.

SUMMARY: These regulations specify procedures for implementing the authority provided to the Department by section 1128A and 1128(b) of the Social Security Act (the Act), as amended by section 2105 of the Omnibus Budget Reconciliation Act of 1981 (Pub. L. 97-35) and section 137(b)(26) of the Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. 97-248), to impose administratively civil money penalties and assessments for making false or certain other improper claims or requests for payment in the Medicare, Medicaid, or Maternal and Child Health Services Block Grant programs. The statute also permits an individual upon whom the Department imposes a civil money penalty or assessment to be suspended from participation in the Medicare and Medicaid programs.

Under section 1128A violators may be fined up to $2,000 as a penalty for each false or improper item or service claimed and an additional assessment of up to twice the amounts falsely claimed. The procedures set forth in the regulations provide persons liable for civil money penalties and assessments an opportunity for a hearing on the record in accordance with the Administrative Procedure Act, for a discretionary appeal to the Secretary, and for judicial review of the Secretary's final determination.

DATE: These regulations are effective September 26, 1983.

FOR FURTHER INFORMATION CONTACT: Harvey Yampolsky, Assistant General Counsel, Inspector General Division, Room 5541, HHS North Building, 330 Independence Avenue, SW., Washington, D.C. 20201, (202) 472-5335.

SUPPLEMENTARY INFORMATION:

I. Regulatory Burden

Regulatory Impact Analysis

This regulation is not a major rule within the meaning of Executive Order 12291 because it does not meet any of the criteria set forth in section 1(b) of the Order, and thus does not require a regulatory impact analysis.

Regulatory Flexibility Analysis

This regulation establishes procedures for imposing civil money penalties, assessments, and suspensions against those who have violated existing requirements of the Medicare, Medicaid, and Maternal and Child Health Services Block Grant programs. It does not impose any new requirements on participants in those programs. Thus, under the Regulatory Flexibility Act, the Secretary certifies that the rule will not have a significant economic impact on a substantial number of small entities.

Recordkeeping and Reporting Requirements

This regulation imposes no recordkeeping or reporting requirements and therefore is not subject to the Paperwork Reduction Act of 1980 (Pub. L. 96-511).

II. Background

The Department published proposed rules for public comment on December 30, 1982, 47 FR 58309. During the 60-day comment period, the Department received and considered comments from 14 sources: four State agencies; four national associations; the Administrative Conference of the United States; one Congressman; one law firm; one public interest law center; one nursing home corporation; and one consulting firm.

Their comments, and our responses are set forth below in the section-by-section analysis. In addition, we made changes in the proposed rule, as follows:

III. Revisions

A. *Numbering.* After the notice of proposed rulemaking was published on December 30, 1982, when the Department proposed adding 45 CFR Part 100 to implement sections 1128A and 1128(b) of the Act, the Department published on January 24, 1983 a notice of proposing rulemaking to implement Executive Order 12372, which also proposed to add a new 45 CFR Part 100. Accordingly, we have designated the regulations implementing the civil monetary penalties statute as 45 CFR Part 101.

B. *Period of Limitations.* Although section 1128A of the Act does not contain a statute of limitations provision limiting the time within which an action may be instituted, and there were doubts whether any general limitations statute applied to proceedings under that section, we have added a regulation, § 101.132, which limits the Department's authority to commence a proceeding under section 1128A to five years from the date that the right of action accrues.

C. *Discovery.* We have liberalized to some extent the discovery provisions of the proposed regulation to permit the earlier exchange of witness lists, the prehearing discovery of prior statements by prospective witnesses, and for depositions of experts in support of or opposition to basing a proposed penalty or assessment on a statistical sampling study.

D. *Statistical Sampling.* To clarify the type of evidence admissible in proceedings brought under section 1128A, we have added section 101.133 which provides for the use of statistical sampling studies in establishing the number and amount of claims and/or requests for payment.

E. *Appeal to the Secretary.* In response to a comment from the Administrative Conference of the United States, we modified final section 101.125(f) to provide for discretionary, rather than mandatory, review by the Secretary.

F. *Administrative Hearing Details.* Final § 101.130 was expanded to provide for routine housekeeping details, such as the computation of time, the form and manner of filing and disposition of motions, and the like.

G. *Mitigating and Aggravating Circumstances.* Under section 1128A(c), before imposing any penalty or assessment the Secretary must consider in every case (1) the nature and circumstances of the claim, (2) the degree of culpability, history of prior offenses, and financial condition of the respondent, and (3) such other matters as justice may require. A number of commenters criticized the way we chose to limit the discretion of those considering these factors in proposing and imposing sanctions under the proposed regulation. Although we have preserved the general format of mitigating and aggravating factors, we have eliminated fixed numbers as triggering devices. As we gain greater experience in imposing sanctions under the statute, we may further refine the guidelines, but at this early stage, we believe that increased flexibility is preferable. At the same time, we have developed a range within which the amount of penalties and assessments should fall in most cases. As a general matter, penalties and assessments should never be less than double the amount of damages. Where there are substantial or several aggravating circumstances, the combined penalty and assessment should approach or equal the statutory maximum, and where there are substantial or several mitigating circumstances, they should recede from the statutory maximum. In addition, decisions concerning suspension will be based on the same criteria as are used to determine penalties and assessments.

IV. General Comments

Comment: An association remarked that the regulations should be withdrawn because they fail to include any reference to the role of the Attorney General in authorizing the Secretary to initiate a proceeding under section 1128A(a) as provided in section 1128(b)(1) (42 U.S.C. 1320a–7a(b)(1)).

Response: Section 1128A(b)(1) (42 U.S.C. 1320a–7a(b)(1)) provides that the Secretary may initiate a proceeding under subsection (a) "only as authorized by the Attorney General pursuant to procedures agreed upon by them." A memorandum of understanding (MOU) between this Department and the Department of Justice establishes the procedures pursuant to which the Secretary will exercise authority under the statute. It is apparent from the face of the cited provision that the contents of the MOU are rules of procedure that need not be published under 5 U.S.C. § 553(b). It is clear that the procedures are to be mutually agreeable to the Secretary and to the Attorney General, and may be changed by them without notifying or consulting the public.

Comment: Three commenters criticized the regulations for failing to include limitation on the time period during which the Department could seek penalties, assessments, and/or suspensions under § 1128A(a) and § 1128(b). They noted that this could result in unfairness in cases where the passage of time would impair a respondent's ability to defend an action due to lack of memory on the part of witnesses, loss of documentation, etc. One suggested that the six-year statute of limitations in the False Claims Act (31 U.S.C. 3731(b)) might be appropriate. All suggested tailoring the limitations period to the time requirements imposed by the Medicare and Medicaid programs for the retention of records.

Response: We agree that a limitations period should be stated expressly in the regulations. We have included final § 101.132, which bars the Department from proceeding against a party for violations concerning which a right of action has accrued more than five years before the filing of a Notice of Proposed Determination as provided in § 101.108(a). The five-year period chosen comports with 28 U.S.C. 2462, governing actions to enforce civil fines, penalties and forfeitures. This time period is sufficient to protect a respondent from being forced to defend stale claims.

Comment: In response to alleged statements by some Department employees that the regulations would permit imposition of penalties and assessments against States, one commenter noted that Congress did not intend to include States within the reach of the statute and that the definitions of "Person" and "State" in proposed § 100.101 did not support such an interpretation.

Response: Section 1128A(a) (42 U.S.C. 1320a–7a(a)) reaches broadly by its terms "any person (including an organization, agency, or other entity)" that presents or causes to be presented false or improper claims, or requests for payment. Thus, Congress clearly intended the Secretary to have authority to impose civil money penalties and/or assessments against those who present or cause to be presented such false or improper claims in the Medicare, Medicaid, and Maternal and Child Health Services Block Grant programs. Because State, county, and municipal institutions are among providers of services in these programs, they are within the ambit of the statute. Public entities may also be among those persons receiving grant funds from a State under the Maternal and Child Health Services Block Grant program. Nothing in the statute or legislative history provides a rationale for excluding these entities or their agents and employees from the scope of the plain meaning of the statute. Hence, we have clarified the proposed definition of "Person" in final § 101.101 by adding the words "public or private" following the word "entity". We recognize that the effect that imposing a penalty, assessment, or suspension on a public entity will have on State or local taxpayers supporting it may be a circumstance that justice may require us to consider.

Comment: A large number of commenters objected to the Department's intention, as stated in the preamble to the NPRM, to apply the statute to claims or requests for payment made before the statute's effective date, August 13, 1981. Some stated that this violated the ex post facto clause of the Constitution, others labeled it unfair, while some simply stated that retroactive application of the statute contravened congressional intent, express or presumed.

Response: The ex post facto clause of the United States Constitution, art. I, section 9, cl. 3, does not bar the retrospective application of this statute to claims filed before the act's effective date. It is well-settled that the clause pertains only to criminal statutes that make punishable conduct that was not criminal at the time it was committed, that increase the amount of punishment for past conduct, or that alter the rules of evidence to make it easier to convict a criminal defendant. *Calder v. Bull*, 3 U.S. (3 Dall.) 386 (1798).

Although Congress did not expressly make section 1128A applicable to claims made before the effective date of the statute, there is some indication in the legislative history that Congress intended it to so apply. The provision was conceived as an alternative remedy to criminal prosecution of cases of fraud, which were not being prosecuted. *See*, II H.R. Rep. No. 97–158, 97th Cong., 1st Sess. 344 (1981) and III H.R. Rep. No. 97–158, 97th Cong., 1st Sess. 329 (1981). The Senate Finance Committee estimated annual cost savings of $7 million for fiscal year 1982, which began two months after enactment. S. Rep. No. 97–139, 97th Cong., 1st Sess. 462 (1981).

Since 1863, Congress has provided for the United States to recover in a civil suit double damages and $2,000 forfeitures from those making or causing to be make false claims against the Federal Government. 31 U.S.C. § 3729, formerly 31 U.S.C. § 231. Section 1128A is closely modeled on that statute. Although there are some differences between them, we have restricted the retrospective application section 1128A to circumstances in which the respondent would have been liable under the False Claims Act. 45 CFR 101.114(b). With respect to claims presented before August 13, 1981, we have also limited substantive liability to that which would have been imposed under that statute.

As thus interpreted by the Department, section 1128A adds an alternative administrative procedure for the recovery of damages and forfeitures. As such, it falls within the principal exception to the general rule that statutes are presumed to operate prospectively: Where a statute changes a remedy or a procedure for the enforcement of a right without affecting the substantive liabilities of the parties, it is presumed to apply to all cases brought on or after the effective date even though the cause of action arose before that date.

Judged by the fairness considerations underlying both the ex post facto and the due process clauses, the retroactive amount of damages. Where there are substantial or several aggravating circumstances, the combined penalty and assessment should approach or equal the statutory maximum, and where there are substantial or several mitigating circumstances, they should recede from the statutory maximum. In addition, decisions concerning suspension will be based on the same criteria as are used to determine penalties and assessments.

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Comment: Three commenters criticized the regulations for failing to include limitation on the time period during which the Department could seek penalties, assessments, and/or suspensions under § 1128A(a) and § 1128(b). They noted that this could result in unfairness in cases where the passage of time would impair a respondent's ability to defend an action due to lack of memory on the part of witnesses, loss of documentation, etc. One suggested that the six-year statute of limitations in the False Claims Act (31 U.S.C. 3731(b)) might be appropriate. All suggested tailoring the limitations period to the time requirements imposed by the Medicare and Medicaid programs for the retention of records.

Response: We agree that a limitations period should be stated expressly in the regulations. We have included final § 101.132, which bars the Department from proceeding against a party for violations concerning which a right of action has accrued more than five years before the filing of a Notice of Proposed Determination as provided in § 101.106(a). The five-year period chosen comports with 28 U.S.C. 2462, governing actions to enforce civil fines, penalties and forfeitures. This time period is sufficient to protect a respondent from being forced to defend stale claims.

Comment: In response to alleged statements by some Department employees that the regulations would permit imposition of penalties and assessments against States, one commenter noted that Congress did not intend to include States within the reach of the statute and that the definitions of "Person" and "State" in proposed § 100.101 did not support such an interpretation.

Response: Section 1128A(a) (42 U.S.C. 1320a–7a(a)) reaches broadly by its terms "any person (including an organization, agency, or other entity)" that presents or causes to be presented false or improper claims, or requests for payment. Thus, Congress clearly intended the Secretary to have authority to impose civil money penalties and/or assessments against those who present or cause to be presented such false or improper claims in the Medicare, Medicaid, and Maternal and Child Health Services Block Grant programs. Because State, county, and municipal institutions are among providers of services in these programs, they are within the ambit of the statute. Public entities may also be among those persons receiving grant funds from a State under the Maternal and Child Health Services Block Grant program. Nothing in the statute or legislative history provides a rationale for excluding these entities or their agents and employees from the scope of the plain meaning of the statute. Hence, we have clarified the proposed definition of "Person" in final § 101.101 by adding the words "public or private" following the word "entity". We recognize that the effect that imposing a penalty, assessment, or suspension on a public entity will have on State or local taxpayers supporting it may be a circumstance that justice may require us to consider.

Comment: A large number of commenters objected to the Department's intention, as stated in the preamble to the NPRM, to apply the statute to claims or requests for payment made before the statute's effective date, August 13, 1981. Some stated that this violated the ex post facto clause of the Constitution, others labeled it unfair, while some simply stated that retroactive application of the statute contravened congressional intent, express or presumed.

Response: The ex post facto clause of the United States Constitution, art. I, section 9, cl. 3, does not bar the retrospective application of this statute to claims filed before the act's effective date. It is well-settled that the clause pertains only to criminal statutes that make punishable conduct that was not criminal at the time it was committed, that increase the amount of punishment for past conduct, or that alter the rules of evidence to make it easier to convict a criminal defendant. *Calder* v. *Bull*, 3 U.S. (3 Dall.) 386 (1798).

Although Congress did not expressly make section 1128A applicable to claims made before the effective date of the statute, there is some indication in the legislative history that Congress intended it to so apply. The provision was conceived as an alternative remedy to criminal prosecution of cases of fraud, which were not being prosecuted. *See*, II H.R. Rep. No. 97–158, 97th Cong., 1st Sess. 344 (1981) and III H.R. Rep. No. 97–158, 97th Cong., 1st Sess. 329 (1981). The Senate Finance Committee estimated annual cost savings of $7 million for fiscal year 1982, which began two months after enactment. S. Rep. No. 97–139, 97th Cong., 1st Sess. 462 (1981).

Since 1863, Congress has provided for the United States to recover in a civil suit double damages and $2,000 forfeitures from those making or causing to be make false claims against the Federal Government. 31 U.S.C. § 3729, formerly 31 U.S.C. § 231. Section 1128A is closely modeled on that statute. Although there are some differences between them, we have restricted the retrospective application section 1128A to circumstances in which the respondent would have been liable under the False Claims Act. 45 CFR 101.114(b). With respect to claims presented before August 13, 1981, we have also limited substantive liability to that which would have been imposed under that statute.

As thus interpreted by the Department, section 1128A adds an alternative administrative procedure for the recovery of damages and forfeitures. As such, it falls within the principal exception to the general rule that statutes are presumed to operate prospectively: Where a statute changes a remedy or a procedure for the enforcement of a right without affecting the substantive liabilities of the parties, it is presumed to apply to all cases brought on or after the effective date even though the cause of action arose before that date.

Judged by the fairness considerations underlying both the ex post facto and the due process clauses, the retroactive application of section 1128A in the manner proposed is not unfair. Those who filed false claims before the date of enactment of section 1128A were already on notice that their misconduct subjected them to liability for double damages and a $2,000 forfeiture per claim in a civil suit. *See, e.g., Peterson* v. *Richardson,* 370 F. Supp. 1259 (N.D. Tex. 1973), *aff'd sub nom. Peterson* v. *Weinberger,* 508 F.2d 45 (5th Cir. 1975), *cert. denied,* 423 U.S. 830; *United States ex rel. Davis* v. *Long's Drugs,* 411 F. Supp. 1144 (S.D. Cal. 1976). They have no vested right in a particular mode of procedure being used to determine that liability as long as the procedures employed afford due process. *Crane* v. *Hahlo,* 258 U.S. 142 (1922); *Montana Power Co.* v. *Federal Power Commission,* 144 App. D.C. 250, 445 F.2d 739 (D.C. Cir. 1970) (en banc), *cert. denied,* 400 U.S. 1013. Thus, retroactive application of the procedures specified in section 1128A neither deprives respondents of vested rights nor interferes with their reasonable expectations at the time they committed the acts giving rise to liability.

Comment: One State agency suggested that penalties be imposed where claims are false or improper due to consistent and inordinate inaccurate billing practices by those using tape billing and tape billing agents. Where such claims are consistently submitted by those failing to follow billing instructions, the State agency recommended that it be allowed to notify them that it would recommend them for civil money penalties and that it would not accept tape billing until the procedures were corrected.

Response: We believe that the statute and proposed regulations as worded already include the described practices. As to the State's authority to refuse tape billings, that is a question of State authority under its Medicaid plan.

V. Section-by-Section Analysis

Section 101.101 Definitions.

Comment: Two commenters objected to the definition of "item or service", which, in "the case of a claim based on costs" means "any entry or omission in a cost report, books of account or other documents supporting the claim." Because penalties and assessments are computed on the basis of "items or services" falsely claimed, the commenters thought it was unfair for the Department to reach behind the false entry on the cost report to multiply the number of false items or services found in the supporting documents.

Response: No change has been made in the final regulation. The definition of "item or service" is taken directly from the statute, 42 U.S.C. 1320a-7a(h)(3). Furthermore, we should note that the definition of "claim" in the statute, and reflected in our regulation, would include any application for reimbursement submitted by a hospital pursuant to the Department's procedures for making payment under the prospective reimbursement methodology authorized by Pub. L. 98-21.

Section 101.102 Basis for civil monetary penalties and assessments.

Comment: One commenter noted that the statute authorizes the imposition of a penalty only, not an assessment, when a person requests payment in violation of an assignment agreement under section 1842(b)(3)(B)(ii) or an agreement with a State agency not to charge a person for an item or service in excess of the amount permitted to be charged. The modification of section 1128A(a) by Pub. L. 97-248 clearly implies a distinction between "request for payment" and "claim" (defined in section 1128A(h)(2)), upon which an assessment is based.

Response: We agree. Sections 101.102 and 101.104 have been modified accordingly.

Comment: One commenter suggested that the regulation clarify that providers shall not be held liable for errors committed by State agencies or intermediaries in their instructions or interpretations to providers.

Response: This comment does not entail a change in the proposed regulation. The Department will not seek to impose a civil money penalty on a provider that detrimentally relied in good faith on the erroneous advice of the State agency or intermediary. Where the basis for a penalty is section 1128(a)(1)(A), the provider's good faith reliance on erroneous instructions or interpretations would tend to negate that the provider knew or should have known that the items or services for which it was claiming reimbursement were not provided as claimed. With respect to section 1128(a)(2), it is difficult to see how a provider could be held liable for violating an agreement with the State agency if it is interpreting the agreement in the same way as the State agency.

Comment: One commenter stated that the final regulations should clarify that providers should not be liable for claims for items or services made by others who provide contract services in the institution but who claim reimbursement independently under separate provider numbers.

Response: The comment does not require a change in the proposed regulation. Where a person provides services in an institution and files claims for such services as a separate entity, the institution would neither have presented nor caused to be presented false or improper claims, and hence would not be liable under the statute or the regulation.

Comment: One commenter recommended that this regulation specify criteria for determining when services are "substantially in excess of the needs of individuals" or "of a quality which fails to meet professionally recognized standards of health care" as used in section 1862(d)(1)(C) of the Act (42 U.S.C. 1395y(d)(1)(C)).

Response: No change is required in the proposed regulation. Because civil monetary penalties and assessments may be levied against persons under section 1128A(a)(1)(B) only if they present or cause to be presented claims for reimbursement *after* they have been suspended or excluded under the provision cited therein, it would not be appropriate to specify in regulations implementing section 1128A the criteria for excluding persons under section 1862(d)(1)(C).

Comment: One commenter stated that in enumerating the bases for imposition of a civil monetary penalty under section 1128A(a)(1)(B), the regulation should reference exclusion under section 1156 pursuant to a determination by a Professional Review Organization.

Response: The regulation includes all of the bases for exclusion cited in section 1128A(a)(1)(B) of the statute.

Section 101.104 Amount of assessment.

Comment: Two commenters objected that the proposed regulation permitted the Secretary to make assessments which exceed any damage the government may have suffered. They suggested that the final regulation should provide that the amount of the assessment be limited to twice the amount falsely claimed, as provided in the False Claims Act, 31 U.S.C 3729.

Response: The proposed regulation follows the statute, and no change is required. Under the False Claims Act (31 U.S.C. 3729, formerly 31 U.S.C. 231), the United States is entitled to recover, in addition to a forfeiture of $2,000 per false claim, "2 times the amount of damages the government sustains . . . ." and the costs of the civil action. Section 1128A(a), on the other hand, subjects the person filing a false or improper claim to "an assessment of not more than twice the amount claimed for each such item or service in lieu of damages sustained by the United States or a State agency because of such claims." The amount of actual damages sustained as a result of fraud has often been difficult to prove. In enacting the latter provision, Congress clearly intended to obviate the need for the government to prove the amount of damages in order to make an assessment. Because the costs of investigating the false claim and of pursuing administrative sanctions are not separately recoverable, it is reasonable for Congress to have concluded that twice the amount claimed for such items or services would fully compensate the government for all losses incurred as a result of the claim.

However, although the statute *permits* the Secretary to assess *not more than* twice the amount claimed for such items or services, the Secretary exercises discretion in fixing the amount of the assessment, taking into account the factors listed in section 1128A(c). Hence, in instances where the actual damages to the government may be readily calculated, perhaps as a result of evidence supplied by respondents in mitigation of a proposed penalty, the amount of actual damages suffered by the government will be a factor that justice requires be taken into account in arriving at a proper assessment. *See*, comments and responses to § 101.106 *infra*.

Section 101.105 Suspension from participation in Medicare or Medicaid

Comment: Two commenters noted that section 1128(b) (42 U.S.C. 1320a–7(b)) allows the State to request, and the Secretary to grant, a waiver of a requirement that the State suspend from the Medicaid program a person upon whom a civil money penalty or assessment has been imposed. The proposed regulation did not reflect this.

Response: The final regulation, § 101.105(a), has been revised to provide for waivers of suspensions from the Medicaid program when a shortage of providers or other health care personnel in the area would deny Medicaid beneficiaries access to medical care or when such beneficiaries would suffer hardship. This is similar to the situation under which waivers are currently granted under section 1128(a) (42 U.S.C. 1320a–7(a)). 42 CFR 455.214.

Comment: One commenter suggested that the regulation should make it clear that there can be no final decision by the Secretary if an appeal is pending.

Response: See, comments and response to § 101.128, *infra*.

Comment: Given the trauma that relocation may have on nursing home residents in the event the facility is suspended, a commenter recommended that a long-term care facility be suspended only "in the most egregious situations" and only after residents of the facility have been given notice and an opportunity to intervene.

Response: We recognize the significant interests that Medicaid and Medicare beneficiaries, as well as other residents in long-term care facilities, have in avoiding trauma associated with relocation. We believe that the suspension provisions of the statute and the proposed regulations take them into account in the following ways.

First, where the long-term care facility is faced with a proposed suspension in conjunction with a proposed civil money penalty or assessment, it will be in that facility's interest to present evidence of the hardships that residents would suffer if it were suspended. This is arguably a matter that justice requires be taken into account under the final regulation. 45 CFR 101.106 and 101.107.

Secondly, where the Secretary decides to suspend a long-term care facility under Medicare, a State may request a waiver from the Secretary to avoid its suspension under Medicaid as discussed above.

Finally, even after the facility is finally suspended, section 1128(c) (42 U.S.C. 1320a–7(c)) provides that payment may be made for up to 30 days with respect to post-hospital extended care services furnished to any eligible individual who was admitted to such institution prior to the effective date of the suspension.

To augment these protections further, we have provided in final § 101.105(c) that when the Inspector General proposes to suspend a long-term care facility from participation in Medicare and Medicaid, he will notify the appropriate State Office of Aging, the long term-care ombudsman, and the State Medicaid agency. The ombudsman or agency would then be in a position to inform the residents of the facility that the suspension has been proposed and to make arrangements for alternative placing in the event that the facility is subsequently suspended. Where the State officials determine that suspension of the provider would result in denying Medicaid beneficiaries adequate access to medical care, or in hardship for such beneficiares, they could suggest that the State Medicaid agency request a waiver under § 101.105(a).

We do not believe that the interests of nursing home residents also require that they be authorized to intervene as parties to the proceeding, which could unduly complicate and prolong the administrative proceedings.

Comment: A commenter recommended that the effective date of the suspension "should allow sufficient time to plan relocations carefully" in addition to the 30 days of continued Federal financial participation (FFP). The commenter did not recommend how long that might be.

Response: We believe that the response to the preceding comment addresses this concern. By notifying the State agency responsible for protecting the interests of its elderly citizens, particularly those in nursing homes, at the earliest time possible—when suspension is proposed—the Secretary gives those in a position to aid in the possible relocation as much time as possible to make alternative arrangements. In addition, the suspension, if it occurs, does not become effective until 15 days after the date it becomes final. This 15 days is in addition to the 30 days with respect to which FFP continues for post-hospital extended care services after the suspension becomes effective.

Comment: A commenter expressed concern for the continuity of care to beneficiaries whose practitioner or provider is suspended. He recommended that the regulations require the suspended person to inform his or her patients of his suspension and to recommend another approved practitioner or provider to continue services.

Response: We believe the final regulations answer these concerns. Section 101.129 has been amended to provide for public notice in the area served by a suspended person. *Cf.* 42 CFR 420.124. Furthermore, as the State Medicaid agency is notified, it should publicize the suspension among beneficiaries, social workers, and its employees to reduce hardship on the beneficiary population. With reimbursement suspended, the suspended person will have every incentive to inform his or its beneficiary patients. However, once a person is suspended, the Department no longer has any leverage to enforce an obligation upon the person to refer his or its patients to an approved provider or practitioner.

Comment: One Departmental commenter noted that the proposed regulation should eliminate the need for the Administrator of HCFA to concur in the decision to suspend a person as the authority to suspend and exclude persons from Medicare has been transferred from the Administrator of HCFA to the Inspector General.

Response: Final regulation § 101.105 has been revised in accordance with the comment to reflect the delegation of suspension and exclusion authority to the Inspector General effective April 18, 1983.

Comment: One State agency noted that the proposed regulation is unclear regarding the effect that a person's suspension under section 1128(b) would have on the the person's participation under the Maternal and Child Health Services Block Grant program (MCH program).

Response: We agree. In providing for the suspension of a person from the Medicare and/or Medicaid programs under section 1128(b), Congress did not specify the effect that this would have on the person's continued participation, if any, under a State's MCH program even though misconduct in the latter program may be the basis for suspension from the former programs. Also, in restructuring title V of the Act in Pub. L. 97-35, Congress did not require States to suspend from participation in their MCH programs those persons who had been suspended from Medicare and/or Medicaid as Congress did with respect to Medicaid under section 1902(a)(39) of the Act (42 U.S.C. 1396a(a)(39)).

The absence of such a requirement is, of course, consistent with the block grant model, which permits greater latitude to the State in administering federal grants in aid.

However, if a person has been suspended from participation in the Medicare and/or Medicaid programs under section 1128(b), it seems reasonable to conclude that Congress intended the State to be able to suspend the person from its MCH program, especially where misconduct in that program is what prompted the imposition of civil money penalties and/or assessments and the suspension. Thus, final regulation § 101.129 provides that notice will be given to the State agency responsible for administering the State's MCH program under section 509(b) of the Act (42 U.S.C. 709(b)). The State may then take whatever steps it deems appropriate.

Section 101.106 Determining the amount of the penalty and assessment.

Comment: Several commenters criticized proposed subsection (b)(1). Two said that there should be a greater difference between those factors which would be considered aggravating and those which would be considered mitigating, *e.g.*, in proposed § 100.106(b)(1). Another challenged the dollar figures and other benchmarks as arbitrary.

Response: In consideration of the comments and upon further reflection, we have made several changes in this section. Under section 1128A(c), in determining the amount or scope of any penalty or assessment, the Secretary is obliged to consider "the nature of claims and the circumstances under which they were presented, the degree of culpability, history of prior offenses, and financial condition of the person presenting the claims, and such other matters as justice may require." We proposed to guide decision-makers' discretion in imposing penalties and assessments by refining these factors by rule, defining what would be considered aggravating and mitigating circumstances. We believed that this would ensure fairness and facilitate settlements because all parties would be able to calculate the appropriate penalty and/or assessment.

On the one hand, we recognized that such a process inevitably involves drawing lines, and that line-drawing inevitably invites the comment that the lines have been drawn arbitrarily. On the other, where few lines are drawn, the proposed rule is criticized for permitting the Secretary unfettered discretion in imposing penalties and assessments.

Ultimately, then, the question is one of balancing flexibility against predictability. In reconsidering these factors in light of the comments, we decided that without experience with the number of claims involved, the period over which they were submitted, the culpability of respondents, etc., the balance would be better struck, at least initially, in favor of more flexibility. Hence, although we continue to regard it as a mitigating circumstance where the total amount of the items and services claimed is less than $1,000, we have deleted a specific dollar figure for defining an aggravating circumstance.

Comment: A commenter suggested that "reciprocal billing", which it defined as the practice of one physician performing services for another physician where the latter bills as though he had performed the service himself (*e.g.*, as a weekend fill-in), should be "exempted" or considered a mitigating circumstance.

Response: If we understand the comment correctly, it is asking the Secretary to approve of this practice. Even if, as the commenter states, this is "common and accepted practice" and does not harm federally financed health programs, this regulation is not the place for such a policy determination to be given expression. In any case involving "reciprocal billing", the Inspector General's determination would be guided by the applicable standards of HCFA.

Comment: Several commenters took exception to proposed §100.106(b)(2), concerning degree of culpability. One commenter thought that to consider it a mitigating circumstance if the false or improper claim was the result of an unintentional or unrecognized error was inconsistent with proposed § 100.102(a)(1)(ii). Another objected that it should not be a mitigating factor that an improper claim was the result of unintentional or unrecognized error; "a simple, honest mistake" should not subject anyone to liability for a penalty or assessment. Still another commenter objected that "knowledge" should not be an aggravating factor because it is "simply an element of the offense."

Response: These comments show a misunderstanding of the proposed regulation. Although liability for submitting a "false" claim under section 1128A(a)(1)(A) requires that respondent "knows or has reason to know" that the items or services for which payment is claimed were not provided as claimed, "knowledge" *per se* is not an element of any of the practices giving rise to liability under section 1128A(a). In fact, as noted above, the language just quoted indicates that Congress intended to subject to civil money penalty liability those who present or cause to be presented claims for items or services that they did *not* know, but *should* have known, were not provided as claimed. Sections 1128A (a)(1)(B) and (a)(2) are completely silent as to any element of knowledge or intent on the part of the respondent.

The statute sweeps within its ambit not only the knowing, but the negligent, and we are obliged to give it its scope. Under section 1128A(c)(2) we are also obliged to consider the "degree of culpability" in determining the amount or scope of any penalty or assessment. Thus, it seems reasonable to conclude that Congress intended that those who had inadvertently and unintentionally made a false or improper claim or request for payment, all other things being equal, should not be subjected to as large a penalty or assessment as those who did so knowingly and intentionally. This judgment is reflected in final § 101.106(b)(2).

Comment: A commenter noted that the reference in the last sentence of proposed § 100.106(b)(2) should have been "§ 100.102 (a)(1)(ii) or (a)(2)" rather than § 100.102 (a) or (b)". Another disagreed with language in proposed § 100.106(b)(2) that made it an aggravating circumstance "for claims subject to a determination under § 100.102 (a) or (b)," if the respondent "knew that no payment could lawfully be made for the claim." The commenter regarded this provision as usurping a providers' statutory right to challenge in court the intermediary's and HCFA Administrator's determination on disputed elements of cost.

Response: The first commenter is correct, and final § 101.106(b)(2) has been modified to reflect our original intent to make an aggravating circumstance the knowing submission of false claims or the knowing making of claims or requests for payment that cannot be paid because a person had been excluded from program reimbursement or because payment would violate an assignment agreement under section 1842(b)(3)(B)(ii) of the Act or an agreement with a State agency.

Contrary to the second commenter's assertion, the proposed regulation was not an "attempt to preempt a provider's legal right to challenge an administrative determination as to the allowability of cost elements of service". Where a provider claims costs it has incurred in providing services to beneficiaries in order to preserve its right to appeal a denial of those costs by the intermediary, the claim is not false under the statute or the regulation. The cost report represents that the provider incurred costs in providing items and services to beneficiaries. It is then up to the intermediary, the PRRB, and the Administrator to determine whether they are allowable under Medicare as costs reasonably related to patient care.

Comment: A commenter recommended that proposed § 100.106(b)(3) should make it clear that "prior offense" is one other than that complained of in the present proceeding, and stated that a final determination of culpability must have been made.

Response: We believe that the proposed regulation was sufficiently clear that the term "prior offenses" does not include the claims or requests for payment that are the subject of the instant proceeding. Further, we do not intend to utilize prior offenses as an aggravating factor unless there has been a final adjudication of liability. In the case of criminal and civil sanctions, a judgment of a United States District Court or state trial court would constitute such a final adjudication. In the case of administrative sanctions, final agency action on the sanction would constitute a final adjudication. The pendency of appeals from such final adjudications will not affect their finality for the purposes of this section. This is in accord with established principles of res judicata and collateral estoppel. Finally, although prior offenses related to reimbursement for medical services will always be an aggravating circumstance, there will be times when justice may require that certain other convictions be considered an aggravating circumstance under § 101.106(b)(5). For example, a conviction for a white collar crime, such as embezzlement, would reflect on the trustworthiness of the respondent, and would therefore be a circumstance to take into account.

Comment: A number of commenters criticized proposed § 100.106(b)(4) for making a provider's or person's "secure financial position" an aggravating circumstance. One remarked that a person's sound financial condition should be taken into account only if the person profited substantially from the conduct constituting a violation. All said that penalties or assessments should be based on the seriousness of the offense, not on the financial condition of the person, which is tantamount to penalizing the financially successful.

Response: We have deleted sound financial condition as an aggravating circumstance in final § 101.106(b)(4). However, consistent with our view of congressional intent that in all cases the Secretary must consider a person's financial condition, we have provided that the resources available to a respondent will be considered in determining the amount of the penalty and assessment.

Comment: A number of commenters challenged proposed § 100.106(c)(1) for fixing the amount of the assessment at "twice the amount of the claim" as a "general matter". Instead, it should be related to damages. One commenter also noted that proposed § 100.106(c) was deficient in failing to take account of the possibility of mitigating factors.

Response: We have revised subsection (c). As indicated in response to a previous comment, we have deleted many of the specific bench-marks delineating aggravating and mitigating circumstances. However, subsection (c) provides that where there are substantial or several mitigating circumstances, the aggregate amount of the penalties and assessments should be set sufficiently below the maximum amount permitted to be set by § 101.103 to reflect that fact. Conversely, where there are substantial or several aggravating circumstances, the aggregate amount should be set at or sufficiently close to the maximum amount permitted to reflect that fact. As a general matter, unless there are extraordinary mitigating circumstances, the amount of the penalties and assessments should not fall below double the amount of damages sustained by the United States or a State government wh[illegible]ount of damages can be ascerta[illegible]dily. Although we intend to follow these guidelines, § 101.106(d) provides for the exceptional case by indicating that the provisions of § 101.106 are what we have labelled them—"guidelines". Section 101.106(d) also clearly states that the provisions of § 101.106 do not in any way limit the Department's ability to settle any issue or case as provided in § 101.128 or to compromise any penalty and assessment as provided by § 101.128.

Section 101.107 Determining the duration of a suspension.

Comment: One commenter remarked that proposed regulation §§ 100.106 and 100.107 seem to permit the suspension of a person upon whom a penalty or assessment has been imposed "in the seemingly uncontrolled discretion" of the Secretary or the Administrator of HCFA "without regard to the person's . . . state of mind." (*See also*, the following comment and response). The commenter suggested that suspension should only occur where the person has acted in reckless disregard of the person's obligations.

Response: Section 1128(b) permits the Secretary to suspend from Medicare and to order suspended from Medicaid a person upon whom a penalty or assessment under section 1128A has been imposed. Congress established factors to guide the Secretary's discretion in imposing penalties and assessments in section 1128A(c), the predicate to suspension under section 1128(b). Because Congress evidently conceived of civil money penalties and assessments and suspension from participation in federally funded health care programs as a sanctions package with remedial and prophylactic aspects, it is appropriate that the same factors be considered in determining whether to suspend a person and for what period of time. Final regulation § 101.107 reflects that judgment by incorporating the factors of § 101.106. We have also added a provision that where there are aggravating circumstances, a person should be suspended.

Final regulation § 101.106(b)(2) provides that the respondent's knowledge or lack thereof be considered in imposing these sanctions. However, we find no support in the statute for the commenter's position that only those who act in reckless disregard of their obligations should be suspended; both the language and the standard are foreign to it.

Comment: A number of commenters attacked proposed § 100.107 as unacceptably vague. Some also regarded the $5,000 penalty-assessment figure as too low a threshould to trigger suspension. Furthermore, two commenters also said that revised guidelines should apply not only to the duration of the suspension but to a determination of whether to suspend.

Response: Final § 101.107 has been substantially rewritten. It requires the decision-maker to take account of the factors under § 101.106 in reaching a decision to suspend and if so, for how long a period of time. All references to a specific dollar amount triggering suspension have been deleted. Particularly in instances where a heavy penalty and assessment would be warranted but for the poor financial condition of the respondent, the Department may consider its interests vindicated if the respondent is simply suspended from further participation in federally financed health care programs.

Section 101.108 Penalty not exclusive.

Comment: One commenter said that proposed § 100.108 should give specific examples of other laws prescribing penalties.

Response: No change is required. The regulation reiterates a provision of section 1128A(a) that civil monetary penalties and assessments are "in addition to any other penalties that may be prescribed by law". We decline to enumerate all other penalties that are currently or later may be prescribed by law—State or federal. Most obviously, this statute makes it clear that the imposition of criminal penalties does not foreclose the Secretary from imposing civil money penalties and assessments. *Cf. e.g.,* sections 1877 and 1909 of the Act (42 U.S.C. 1395nn and 1396h). The filing of false claims is also grounds for the Secretary to exclude a person from Medicare under section 1862(d) or to terminate a provider agreement under section 1866(b)(2). Regardless of whether these are denominated "penalties", it is clear that civil money penalties and assessments may be imposed in addition to exclusion or termination.

Section 101.109 Notice of proposed determination.

Comment: One commenter regarded proposed § 100.109 as deficient for failing specifically to require the notice to inform respondent of his or its right to an administrative hearing and that failure to respond to the notice could result in automatic imposition of the penalty, assessment, and/or suspension. The commenter suggested that the notice warn in bold letters of the consequences of a failure to respond, and also recommended that where proposed penalties and assessments exceed $1,000, a second notice be sent before the 30-day period commences.

Response: By providing that the notice contain "instructions for responding to the notice; and a copy of the rules", the proposed regulation provided for adequate notice to insure that respondents did not inadvertently waive their rights. Nonetheless, we have added to final § 101.109 a requirement that the notice state respondent's right to a hearing and to request an extension of time and that failure to request a hearing permits imposition of the penalty, assessment, and/or suspension without further right to appeal. We see no reason to require that these elements of notice be highlighted by bold-face type.

We disagree with the comment insofar as it implies that even with these more specific notice provisions it is somehow unfair for the penalties, assessments, and suspensions to take effect upon respondent's failure to respond to the notice. The notice is the functional equivalent of a complaint and summons in a civil proceeding, which a defendant is required to answer to avoid entry of a default judgment against him.

We fail to see how anyone's interest is substantially served by prolonging the process by requiring the Inspector General to send a second notice before imposition of the sanctions. No change is made in this regard.

Comment: One commenter requested that the time for response be extended from 30 days to 60 days.

Response: We believe that in most cases, 30 days will be sufficient time within which to respond, however, final § 101.109(c) allows the Inspector General to extend the 30 day period for good cause shown.

Comment: Two commenters recommended that the respondent be given an opportunity to correct deficiencies and present mitigating factors informally to the Inspector General or to seek modification of the penalty proposed or request a hearing on the limited issue of the amount of the penalty or assessment or the length of the suspension.

Response: We believe that the regulation as proposed adequately meets these concerns. Nothing prevents the respondent from correcting deficiencies whether or not the respondent seeks a hearing. By requesting a hearing, thereby preserving the right to contest in whole or in part liability or the severity of the sanctions proposed, a respondent is not prevented from engaging in negotiations with the Inspector General concerning possible settlement. *See, e.g.,* final [illegible] 128. In fact, we believe that the procedures we have proposed not only permit, but facilitate, fruitful negotiation. We think that requiring the respondent to state his or its position in an answer responding to the Inspector General's position encourages negotiation before hearing. Should negotiations break down, the process is already on track toward a hearing, and is not subject to further delay in determination of the rights of the parties. This encourages the parties to negotiate in good faith and not merely to delay the process. Accordingly, we have not adopted these suggestions.

Comment: One commenter said the regulations were unclear concerning the Department's obligation to inform a respondent that he or it faces suspension, and for how long, at the same time it notifies respondent of proposed penalties and assessments.

Response: Both proposed § 100.109 and final § 101.109 provide that the Inspector General shall include a proposal to suspend in its notice to respondent concerning proposed penalties and assessments.

Section 101.110 Failure to request a hearing.

Comment: A commenter suggested that the Inspector General's denial of a request for an extension under proposed § 100.109(c) should be appealable, and imposition of the penalty should be tolled pending resolution of the appeal.

Response: We anticipate that the Inspector General will grant extensions of the 30 day period for good cause shown. We have attempted to make the procedures for adjudicating liability under the civil monetary penalty statute both fair and expeditious. Little is to be gained by adding an appeals mechanism to resolve a single preliminary issue, and such a mechanism could readily thwart the resolution of substantive issues by encouraging all respondents to request extensions, and if denied, to appeal their denial. No change has been made in final § 101.110.

Section 101.111 Initiation of a hearing.

Comment: A commenter expressed concern with the use of administrative law judges as presiding officers over the hearing in view of allegations that the agency (Office of Hearings and Appeals of the Social Security Administration) has established production quotas for administrative law judges and has pressured them to decide cases in favor of the agency.

Response: Section 1128A(b)(2) (42 U.S.C. 1320a-7a(b)(2)) provides that "[t]he Secretary shall not make a determination adverse to any person under subsection (a) until the person has been given written notice and an opportunity for the determination to be made on the record after a hearing * * *." 5 U.S.C. 554(a) makes section 554 applicable "in every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing, * * *" with some exceptions not here applicable. 5 U.S.C. 554(c) states that "the agency shall give all interested parties opportunities for * * * hearing and decision on notice in accordance with sections 556 and 557 of this title." 5 U.S.C. 556(b) provides that the agency, one or more of the members of the body comprising the agency, or one or more administrative law judges appointed under 5 U.S.C. 3105 shall preside at the taking of evidence.

The statute requires a hearing conducted pursuant to 5 U.S.C. 554, and, unless the agency or one or more of the members comprising it is to preside at the taking of evidence, the Administrative Procedure Act requires that administrative law judges preside.

The Department currently intends to have cases under section 1128A heard by one or more administrative law judges placed under the Departmental Grant Appeals Board rather than in the Social Security Administration's Office of Hearings and Appeals.

Section 101.114 Issues and burdens of proof.

Comment: Two commenters argued that the standard of proof in all circumstances, not only with respect to claims presented before the effective date of the statute, should be clear and convincing, as is required in most federal circuits to establish liability under the False Claims Act, 31 U.S.C. 3729 *et seq.*

Response: We have not made the requested change. As discussed above under comments on § 101.111, section 1128A requires that the Secretary provide an opportunity for a hearing under the Administrative Procedure Act, 5 U.S.C. 554, 556, 557. In *Steadman* v. *Securities and Exchange Commission*, 450 U.S. 91, 94, *rehearing denied*, 451 U.S. 933 (1981), the SEC has found by a preponderance of the evidence that the petitioner had violated, *inter alia*, certain anti-fraud provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Advisers Act of 1940, had barred him from associating with any investment adviser or affiliating with any registered investment company, and had suspended him for one year from associating with any broker or securities dealer. The Court upheld the SEC, holding that in enacting section 7(c) of the Administrative Procedure Act (codified at 5 U.S.C. 556(d)), Congress intended to establish a standard of proof and to adopt the traditional preponderance-of-the-evidence standard in hearings thereunder. *Id.* at 102. As we see no countervailing constitutional consideration nor any higher burden dictated by statute, we will adhere to the standard chosen by Congress to govern hearings under the Administrative Procedure Act.

Comment: One commenter suggested that language be added to proposed § 100.114(c) that would clarify (1) that the final determination in the earlier proceeding was made with respect to the same claims at issue in the civil monetary penalties proceeding and (2) that the respondent was a party in the earlier proceeding.

Response: We believe that the proposed regulation was sufficiently clear concerning the first point. We agree as to the second point, and have modified final § 101.114(c) accordingly.

Section 101.116 Rights of parties.

Comment: A commenter stated that parties should be able to compel the appearance of witnesses.

Response: We agree in principle. However, the statute does not provide for compulsory process in these proceedings. Under 5 U.S.C. 556(c), "subject to published rules of the agency and within its powers, employees presiding at hearings may * * * (2) issue subpoenas authorized by law". Thus, the administrative law judge's authority to compel testimony depends on the Secretary's authority to do so.

42 U.S.C. 1395ii incorporates by reference 42 U.S.C. 405(d), giving the Secretary authority to issue subpoenas requiring the attendance and testimony of witnesses and the production of evidence in matters relating to the administration of the Medicare program. However, no such statute makes similar provision with respect to titles V and XIX, and no general statute confers that power on the Secretary with respect to matters within her jurisdiction. Thus, the regulation restricts the authority of the administrative law judge to issue subpoenas to cases involving the Medicare program.

The Department will consider the feasibility of seeking curative legislation on this point.

The final regulations dealing with subpoenas have been revised. Section 101.116(b) makes clear a party's right and the administrative law judge's duty to compel the attendance of witnesses and the production of evidence in cases involving Medicare. Section 101.116(b) also obliges a party in all hearings to produce for examination upon another party's request any person over whom it has control. A party or prospective witness may file an objection to a notice to appear or a motion to quash a subpoena. That section also provides for enforcement under section 205(e) of the Act.

Section 101.117 Discovery.

Comment: Several commenters urged that proposed § 100.117 should be revised to provide for full discovery. One suggested the first sentence be changed to provide that the ALJ must "allow a requesting party to inspect and copy all documents relevant to the issues in the proceeding that are in the possession or control of the other party." Three commenters stated that the prior statements of witnesses should be made available before the hearing and that depositions, interrogatories, and other forms of discovery should be authorized. One commenter also noted that discovery from experts upon whom the Inspector General intended to rely in cases involving the use of statistical samples is crucial to giving respondents a fair hearing. That comment also stated that there should be included a mechanism for a party to gain access to documents under the control of non-parties.

Response: We have adopted the first suggestion by changing "may" to "shall" in final § 101.117(a).

We have added a new paragraph (c) to final § 101.117 providing for the exchange of witness lists and hearing exhibits before the hearing. At that time, prior statements of witnesses will also be exchanged.

Because we anticipate that as a general matter, issues in these cases will hinge on documentary evidence, we have not provided for full-scale pre-hearing discovery akin to that provided in the Federal Rules of Civil Procedure. We have provided for prehearing access to all unprivileged documents relevant to issues in the proceeding and under the control of another party. Beyond that, in our estimation, the potential for harassment and unnecessary delay outweighs the limited marginal utility of more expansive discovery rights. We have also added a proviso that the regulation shall not be interpreted to require the disclosure of internal government documents prepared in conjuction with the investigation or litigation of the case, such as documents subject to attorney work product and attorney-client privilege.

In final § 101.117(b) we have provided for depositions in the cases in which the Inspector General intends to introduce the results of a satistical sampling study. In such cases, upon request of the respondent, the Inspector General shall make available for deposition, in accordance with Rules 28 and 30 of the Federal Rules of Civil Procedure, the individual(s) responsible for conducting the statistical sampling study. Likewise, a respondent shall make available for deposition any expert whose testimony it intends to introduce to rebut the statistical sample. Failure to make experts available under the regulation bars their testimony or other evidence from them at the hearing.

With respect to compelling the production of documents in the control of third parties, the Secretary, as indicated above, has authority to issue subpoenas only in cases involving Medicare.

Section 101.118 Evidence and witnesses.

Comment: One commenter remarked that "[e]liminating the 'technical rules of evidence' from the hearing is inequitable."

Response: We fail to see how eliminating technical rules of evidence operates to the advantage of one of the parties and hence is inequitable. Furthermore, it is well established that technical rules of evidence applicable in civil jury trials are neither required nor generally employed in hearings under the Administrative Procedure Act, 5 U.S.C. 556(d). In the absence of any rationale offered by the commentor for doing so, we decline to eschew the well-recognized advantages of less restrictive rules of evidence. *See generally*, 3 Davis, Administrative Law Treatise, 2d ed. § 16.4 (1980).

Section 101.120 Ex parte contacts.

Comment: One commenter objected to proposed § 100.120(a), indicating that it was unclear what ex parte matters or what "facts in issue" might require a party to consult with the administrative law judge in the absence of other parties. Two other commenters said that consultation should be restricted to "minor procedural issues", and a record of such consultations should be kept and made available to all parties.

Response: The language in proposed § 100.120(a) was based on 5 U.S.C. 557(d). It was designed to prohibit all ex parte consultations between the administrative law judge and any party on any matter in issue. We have revised final § 101.120(a) to permit ex parte contacts only with respect to the issuance of subpoenas.

The provisions of 5 U.S.C. 557(d) apply to proceedings under this part. 5 U.S.C. 557(d)(1)(C) requires, "the administrative law judge" or any "other employee who is or may reasonably be expected to be involved in the decisional process" to place on the public record of the proceeding a record as specified therein if he "receives or . . . makes or knowingly causes to be made, a communication prohibited by [that] subsection." The agency may then consider a knowing violation of that section sufficient grounds for a decision adverse to the party violating the prohibition. 5 U.S.C. 556(d).

Comment: Two commenters remarked that intervention should be permitted when useful for clarification of issues or when justice may require. As noted and addressed above, another commenter favored intervention by program beneficiary residents of long-term care facility respondents threatened with suspension.

Response: The interests of non-parties, including beneficiaries, can be recognized and considered without allowing them to intervene as parties with full rights of presenting and cross-examining witnesses, attending prehearing conferences, being party to settlement discussions, and the like. Although their interests are not inconsequential, they will be tangential to the fundamental dispute between the Inspector General and the respondent, *viz.*, liability for the severity of proposed penalties, assessments, or suspensions. Allowing them to participate as witnesses, if called by either party or the administrative law judge, would not encumber the process with additional parties litigant.

Section 101.123 Post-hearing briefs.

Comment: One commenter stated that the final regulation should provide for more flexibility by allowing the administrative law judge to extend the thirty-day time limit for submission of briefs, and that the thirty-day limit should begin with the date of receipt of the transcript rather than the termination of the hearing.

Response: We have adopted these suggestions in part. Final regulation § 101.123 provides that the thirty-day period will begin with receipt of the hearing transcript by the parties. It also provides that the administrative law judge may extend the period for up to 60 days in cases of unusual length or complexity or for other good cause shown upon motion of a party.

Section 101.125 Initial decision; administrative review; finality.

Comment: One commenter recommended that proposed § 100.125(f) be modified so that the Secretary retains discretion to review or refuse to review administrative law judges' decisions rather than making review mandatory at the instance of any party. This would conform with Recommendation 68-6(b) the Administrative Conference of the United States, 1 CFR 305.68-6.

Response: We have adopted this suggestion and revised final § 101.125 to provide for review of the administrative law judge's initial decision at the discretion of the Secretary. The Secretary's decision to grant or deny review is not itself reviewable. The only decision that is reviewable is the final decision of the agency, *i.e.*, (a) the initial decision of the administrative law judge if no exceptions are filed or if the Secretary denies review, or (b) the final decision of the Secretary upon discretionary review.

Comment: Two commenters noted the dual review anomaly created by the statute: civil money penalties and assessments are reviewable in the United States Court of Appeals under section 1128a(d) (42 U.S.C. 1320a–7a(d)); whereas, a suspension imposed as a result of a civil money penalties and assessment determination under section 1128(b) (42 U.S.C. 1320a–7a(b)) is reviewable in district court under section 1128(d) (42 U.S.C. 1320a–7(d)).

One of the commenters recommended that we seek legislative correction. The other commenter suggested that the regulation be amended to compel the Secretary to file a motion for a stay in the district court pending a decision by the circuit court on the penalties and assessments when dual appeals have been filed in both the district and the circuit courts, and the suspension is based on civil money penalties and assessments.

Response: The Department will consider the possibility of seeking legislation to correct the situation. While we agree with the idea that until the statute is amended a stay should be sought in the district court, there is no reason why the Secretary should be obliged to seek it. Especially since the adversely affected party will be filing the appeals, it seems more reasonable for that party to move for a stay.

Section 101.126 Settlements.

Comment: One commenter suggested that there ought to be some mechanism whereby the "Secretary's office" is informed of the Inspector General's intent to settle.

Response: We agree that if the Secretary has agreed to review a case, the Inspector General should inform the Secretary if the case is settled after a hearing and before a final action by the Secretary; however, as that is an internal matter, we do not believe that this comment requires a change in the regulation.

Section 101.127 Judicial review.

Comment: Three commenters objected to proposed § 100.127 because it appeared to preclude judicial review in cases where a respondent's failure to file an exception to an administrative law judge's finding or conclusion could be "excused because of extraordinary circumstances" as permitted by section 1128A(d) (42 U.S.C. 1320a–7a(d)).

Response: We have amended final § 100.127 to conform to the statute.

Section 101.128 Collection of penalty and assessment.

Two commenters wrote that proposed § 100.128 should make it clear that penalties, assessments, and/or suspensions cannot be imposed until all appeals have been exhausted.

Response: Sections 101.125(f) (3) and (4) have been revised to make clear that the Secretary's determination (or the ALJ's determination, in the case where the Secretary declines review) becomes final for the purpose of §§ 101.105(b) and 101.128 sixty days after the respondent receives notice of the final determination. This finality is not affected by the pendency of an appeal. This position is in accord with the clearly stated intent of Congress in enacting section 1128A(f) (42 U.S.C. 1320a–7(f)). See H.R. Rep. 97–208, 97th Cong., 1st Sess. Book 2 (Conference Report) p. 950. Further, this position comports with general administrative practice whereby final administrative orders take effect regardless of the pendency of an appeal, unless an administrative or judicial stay is granted. *Cf.*, 5 U.S.C. 705. *See also*, Fed. R. Civ. P. 62; Fed. R. App. P. 18.

Section 1128A does not provide otherwise, and application of the standard rule on finality will discourage frivolous appeals solely to delay payment of penalties and assessments or imposition of a suspension.

We have added a new subsection (5) to § 100.125(f), which creates a procedure for a respondent to seek a stay of the effective date of the final determination pending judicial review. Such requests must be made to the ALJ, who may grant such requests where justice so requires and to the extent necessary to prevent irreparable harm. A determination requiring the payment of money will not be stayed except where the respondent gives a bond or other adequate security.

A decision by the ALJ refusing to grant a stay is not appealable to the Secretary. However, the respondent may seek a stay from the reviewing court.

Section 101.129 Notice to other agencies.

Comment: One commenter said that notice should not be given until all appeals are exhausted.

Response: Section 1128A(g) (42 U.S.C. 1320a–7a(g)) provides that "[w]henever the Secretary's determination to impose a penalty or assessment under subsection (a) of this section becomes final, he shall notify" specified organizations and agencies of the fact and the reasons therefor. As discussed in response to the preceding comment, we interpret "final" in the statute and final § 100.129 as meaning at the expiration of the sixty-day period following the respondent's receipt of the final decision. However, § 100.125(f)(5) permits the respondent to seek a stay of imposition of the suspension.

Comment: One commenter noted that the proposed regulations did not provide for public notice of suspensions as required by 42 U.S.C. 1320a–7(c).

Response: Final § 100.129 provides for notice to the public of final determinations to suspend a person.

List of Subjects in 45 CFR Part 101

Penalties, Medicare, Medicaid, Administrative practice and procedure, Archives and records, Grant programs—social programs, Maternal and child health.

45 CFR Subtitle A—Department of Health and Human Services—is amended as set forth below:

1. The table of contents of Subtitle A is amended by adding at the end thereof the following:

Part

101 Civil Money Penalties and Assessments

2. Subtitle A is amended by adding after Part 100 the following new Part 101:

PART 101—CIVIL MONEY PENALTIES AND ASSESSMENTS

Sec.
101.100 Basis and purpose.
101.101 Definitions.
101.102 Basis for civil money penalties and assessments.
101.103 Amount of penalty.
101.104 Amount of assessment.
101.105 Suspension from participation in Medicare or Medicaid.
101.106 Determinations regarding the amount of the penalty and assessment.
101.107 Determinations regarding suspension.
101.108 Penalty not exclusive.
101.109 Notice of proposed determination.
101.110 Failure to request a hearing.
101.111 Initiation of hearing.
101.112 Parties.
101.113 Notice of hearing.
101.114 Issues and burden of proof.
101.115 Authority of ALJ.
101.116 Rights of parties.
101.117 Discovery.
101.118 Evidence and witnesses.
101.119 Exclusion from the hearing for misconduct.
101.120 Ex parte contacts.
101.121 Separation of functions.
101.122 Official transcript.
101.123 Post-hearing briefs.
101.124 Record for decision.
101.125 Initial decision; administrative review; finality.
101.126 Settlement.
101.127 Judicial review.
101.128 Collection of penalty and assessment.
101.129 Notice to other agencies.
101.130 Form, filing and service of papers; computation of time; motions; disposition of motions.
101.131 Records to be public.
101.132 Limitations.
101.133 Statistical sampling.

Authority: Sec. 1102, 1128 and 1128A of the Social Security Act (42 U.S.C. 1302, 1320a–7 and 42 U.S.C. 1320a–7a).

§ 101.100 Basis and purpose.

(a) *Basis.* This part implements sections 1128A and 1128(b) of the Social Security Act (42 U.S.C. 1320a–7a and 1320a–7(b)).

(b) *Purpose.* This part (1) establishes procedures for imposing civil money penalties and assessments against persons who have submitted certain prohibited claims under the Medicare, Medicaid, or the Maternal and Child Health Services Block Grant programs; (2) establishes procedures for suspending from the Medicare and Medicaid programs, persons against whom a civil money penalty or assessment has been imposed; and (3) specifies the appeal rights of persons subject to a penalty or assessment.

§ 101.101 Definitions.

For purposes of this part:

Act means the Social Security Act.

Agent includes a Medicare fiscal intermediary or carrier, a Medicaid fiscal agent, or any other claims processing agent under the Medicare, Medicaid, or Maternal and Child Health Services Block Grant program.

ALJ means an Administrative Law Judge.

Assessment means the amount described in section 101.104, and includes the plural of that term.

Claim means an application submitted by a person to an agency of the United States or of a State, or an agent thereof, for payment for:

(a) An item or service for which payment may be made under Medicare, or

(b) An item or service for which medical assistance is provided under a State plan for medical assistance, or

(c) An item or service for which payment may be made under the Maternal and Child Health Services Block Grant program.

Department means the Department of Health and Human Services.

General Counsel means the General Counsel of the Department or his designees.

HCFA means the Health Care Financing Administration.

Inspector General means the Inspector General of the Department or his designees.

Item or service includes (a) any item, device, medical supply or service claimed to have been provided to a patient and listed in an itemized claim for program payment or a request for payment, and (b) in the case of a claim based on costs, any entry or omission in a cost report, books of account or other documents supporting the claim.

Maternal and Child Health Services Block Grant program means the program authorized under title V of the Act.

Medicaid means the program of grants to the States for medical assistance authorized under title XIX of the Act.

Medicare means the program of health insurance for the aged and disabled authorized under XVIII of the Act.

Penalty means the amount described in § 101.103, and includes the plural of that term.

Person means an individual, trust or estate, partnership, corporation, professional association or corporation, or other entity, public or private.

Program means the Medicare, Medicaid or Maternal and Child Health Services Block Grant program.

Request for payment means an application submitted by a person to any person for payment for an item or service covered under the Medicare, Medicaid or Maternal and Child Health Services Block Grant program.

Respondent means the person upon whom the Secretary has imposed, or proposes to impose, a penalty or assessment.

Secretary means the Secretary of the Department or his designees.

State includes the District of Columbia, Puerto Rico, the Virgin Islands, Guam, American Samoa, the Northern Mariana Islands, and the Trust Territory of the Pacific Islands.

Suspension means the temporary barring or permanent exclusion of a person from participation in the Medicare or Medicaid programs under section 1128(b) of the Social Security Act.

§ 101.102 Basis for civil money penalties and assessments.

(a) The Department may impose a penalty and assessment against any person whom it determines in accordance with this part has presented or caused to be presented a claim which is for an item or service:

(1) That the person knew or had reason to know was not provided as claimed, or

(2) For which no payment could be made under the program under which it was submitted because:

(i) The person had been excluded under § 1128 of the Act (42 U.S.C. 1320a-7);

(ii) The person had been excluded from eligibility to provide services on a reimbursement basis under section 1160(b) of the Act as that section read prior to enactment of Pub. L. 97–248 (42 U.S.C. 1320c–9(b));

(iii) Payment had been prohibited under title XVIII of the Act because of a determination under section 1862(d) of the Act (42 U.S.C. 1395y(d)); or

(iv) The Secretary had initiated termination proceedings against the person pursuant to a determination by the Secretary under section 1866(b)(2) of the Act (42 U.S.C. 1395cc(b)(2)).

(b) The Department may impose a penalty against any person whom it determines in accordance with this part has presented or caused to be presented a request for payment in violation of the terms of:

(1) an assignment under section 1842(b)(3)(B)(ii) of the Act, or

(2) an agreement with a State agency not to charge a person for an item or service in excess of the amount permitted to be charged.

(c)(1) In any case in which it is determined that more than one person was responsible for presenting or causing to be presented a claim as described in paragraph (a) of this section, each such person may be held liable for the penalty prescribed by this part, and an assessment may be imposed against any one such person or jointly and severally against two or more such persons, but the aggregate amount of the assessments collected may not exceed the amount that could be assessed if only one person was responsible.

(2) In any case in which it is determined that more than one person was responsible for presenting or causing to be presented a request for payment described in paragraph (b) of this section, each such person may be held liable for the penalty prescribed by this part.

§ 101.103 Amount of penalty.

The Department may impose a penalty of not more than $2,000 for each item or service that is subject to a determination under § 101.102.

§ 101.104 Amount of assessment.

A person subject to a penalty determined under § 101.102(a) may be subject, in addition, to an assessment of not more than twice the amount claimed for each item or service which was a basis for the penalty. The assessment is in lieu of damages sustained by the Department or a State agency because of that claim.

§ 101.106 Suspension from participation in Medicare or Medicaid.

(a) A person subject to a penalty or assessment determined under § 101.102 may, in addition, be suspended from participation in Medicare for a period of time determined under § 101.107. The Secretary may require the appropriate State agency to suspend the person from the Medicaid program for a period he shall specify. The State agency may request the Secretary to waive suspension of a person from the Medicaid program under this section if it concludes that, because of the shortage of providers or other health care personnel in the area, individuals eligible to receive Medicaid benefits would be denied access to medical care or that such individuals would suffer hardship. The Secretary will notify the State agency if and when the Secretary waives suspension in response to such a request.

(b) Any suspension under this section shall become effective only after there is a final decision of the Secretary pursuant to § 101.125(f), or at any earlier date that the respondent fails, within the time permitted, to exercise his right to a hearing under § 101.109 or administrative review under § 101.125. The effect of such suspension shall be governed by 42 CFR 420.128.

(c) When the Inspector General proposes to suspend a long-term care facility from the Medicare and Medicaid programs, he shall, at the same time he notifies the respondent, notify the appropriate State Office of Aging, the long-term care ombudsman, and the State Medicaid agency of his intention to suspend the facility.

§ 101.106 Determinations regarding the amount of the penalty and assessment.

(a) In determining the amount of any penalty or assessment, the Department shall take into account, in accordance with this section, (1) The nature of the claim or request for payment and the circumstances under which it was presented, (2) the degree of culpability of the person submitting the claim or request for payment, (3) the history of prior offenses of the person submitting the claim or request for payment, (4) the financial condition of the person presenting the claim or request for payment, and (5) such other matters as justice may require.

(b) *Guidelines for determining the amount of the penalty or assessment.* As guidelines for taking into account the factors listed in paragraph (a), of this section, the following circumstances are to be considered.

(1) *Nature and circumstances of the claim.* It should be considered a mitigating circumstance if all the items or services subject to a determination under § 101.102 included in the action brought under this part were of the same type and occurred within a short period of time, there were few such items or services, and the total amount claimed for such items or services was less than $1,000. It should be considered an aggravating circumstance if such items or services were of several types, occurred over a lengthy period of time, there were many such items or services (or the nature and circumstances indicate a pattern of claims for such items or services), or the amount claimed for such items or services was substantial.

(2) *Degree of culpability.* It should be considered a mitigating circumstance if the claim for the item or service was the result of an unintentional and unrecognized error in the process respondent followed in presenting claims, and corrective steps were taken promptly after the error was discovered. It should be considered an aggravating circumstance if the respondent knew the item or service was not provided as claimed, of if the respondent knew that no payment could be made because he had been excluded from program reimbursement as specified in § 101.102(a)(2) or because payment would violate the terms of an assignment agreement or an agreement with a State agency, under § 101.102(b).

(3) *Prior offenses.* It should be considered an aggravating circumstance if at any time prior to the presentation of any claim which included an item or service subject to a determination under § 101.102, the respondent was held liable for criminal, civil, or administrative sanctions in connection with a program covered by this part or any other public or private program of reimbursement for medical services.

(4) *Financial Condition.* It should be considered a mitigating circumstance if imposition of the penalty or assessment without reduction will jeopardize the ability of the respondent to continue as a health care provider. In all cases, the resources available to the respondent will be considered when determining the amount of the penalty and assessment.

(5) *Other matters as justice may require.* Other circumstances of an aggravating or mitigating nature should be taken into account if, in the interests of justice, they require either a reduction of the penalty or assessment or an increase in order to assure the achievement of the purposes of this part.

(c) As guidelines for determining the amount of the penalty and assessment to be imposed, for every item or service subject to a determination under § 101.102:

(1) If there are substantial or several mitigating circumstances, the aggregate amount of the penalty and assessment should be set at an amount sufficiently below the maximum permitted by § 101.103, to reflect that fact.

(2) If there are substantial or several aggravating circumstances, the aggregate amount of the penalty and assessment should be set at an amount sufficiently close to or at the maximum permitted by § 101.103, to reflect that fact.

(3) Unless there are extraordinary mitigating circumstances, the aggregate amount of the penalty and assessment should never be less than double the approximate amount of damages sustained by the United States, or any State, as a result of claims subject to a determination under § 101.102.

(d) The guidelines set forth in this section are not binding. Moreover, nothing in this section shall limit the authority of the Department to settle any issue or case as provided by § 101.126 or to compromise any penalty and assessment as provided by § 101.128.

§ 101.107 Determinations regarding suspension.

In determining whether to suspend a person and the duration of a suspension, the Department will take into account the circumstances set forth in § 101.106(a) and described in § 101.106(b). Where there are aggravating circumstances as described in § 101.106(b), the person should be suspended. The guidelines set forth in this section are not binding. Moreover, nothing in this section shall limit the authority of the Department to settle any issue or case as provided by § 101.126 or to compromise any suspension as provided by § 101.128.

§ 101.108 Penalty not exclusive.

A penalty imposed under this part is in addition to any other penalties prescribed by law.

§ 101.109 Notice of proposed determination.

(a) If the Inspector General proposes to impose a penalty and assessment, or to suspend a respondent from participation in Medicare or Medicaid, in accordance with this part, he must deliver or send by certified mail, return receipt requested, to the respondent, written notice of his intent to impose a penalty, assessment and suspension, as applicable. The notice will include reference to the statutory basis for the penalty, assessment, and suspension; description of the claims and requests for payment with respect to which the penalty, assessment, and suspension are proposed (except in cases where the Inspector General is relying upon statistical sampling pursuant to § 101.133, in which case the notice shall describe those claims and requests for payment comprising the sample upon which the Inspector General is relying and shall also briefly describe the statistical sampling technique utilized by the Inspector General); the reason why such claims and requests for payment subject the respondent to a penalty, assessment, and suspension; the amount of the proposed penalty, assessment, and the period of proposed suspension (where applicable); any circumstances described in § 101.106 which were considered when determining the amount of the proposed penalty and assessment and the period of suspension; instructions for responding to the notice, including a specific statement of respondent's right to a hearing, of the fact that failure to request a hearing within 30 days permits the imposition of the proposed penalty, assessment, and suspension without right to appeal, and of respondent's right to request an extension of time in which to respond to the notice and a copy of the rules contained in this part.

(b) Within 30 days of the date of receipt of the notice, the respondent may submit:

(1) A written statement accepting imposition of the penalty, assessment, and suspension as proposed; or

(2) A written request for a hearing which shall be accompanied by an answer to the notice that (i) with respect to the claims and requests for payment identified in the notice, admits or denies that the respondent presented or caused to be presented such claims and requests for payment, (ii) states any defense on which the respondent intends to rely, and (iii) may state any reasons which respondent contends should result in a reduction or modification of a penalty, assessment, and suspension.

(c) The Inspector General may extend the 30 day period for good cause shown by the respondent upon request made prior to the expiration of the 30 day period.

§ 101.110 Failure to request a hearing.

If the respondent does not request a hearing within the time prescribed by § 101.109 (b) and (c), the Inspector General may impose the proposed penalty, assessment, and suspension, or any less severe penalty, assessment, and suspension.

The Inspector General shall notify the respondent by certified mail, return receipt requested, of any penalty, assessment, and suspension that has been imposed and of the means by which the respondent may satisfy the judgment. The respondent has no right to appeal a penalty, assessment, and suspension, with respect to which he has not requested a hearing.

§ 101.111 Initiation of hearing.

If the respondent requests a hearing in accordance with § 101.109(b)(2), determination of the penalty, assessment, and suspension will be assigned to an ALJ for hearing.

§ 101.112 Parties.

The Inspector General and the respondent are parties to the hearing.

§ 101.113 Notice of hearing.

The ALJ will send written notice to the respondent and to the Inspector General stating the time and place for the hearing and the issues that will be considered. In fixing the time and place of the hearing, the ALJ will attempt to minimize the costs to the parties.

§ 101.114 Issues and burden of proof.

(a) To the extent that a proposed penalty and assessment is based on claims and/or requests for payment presented on or after August 13, 1981, the Inspector General must prove by a preponderance of the evidence that the respondent presented or caused to be presented such claims and/or requests for payment as described in § 101.102.

(b) To the extent that a proposed penalty and assessment is based on claims presented before August 13, 1981, the Inspector General must prove by clear and convincing evidence that

(1) the respondent presented or caused to be presented such claims as described in § 101.102, and

(2) presenting or causing to be presented such claims could have rendered respondent liable under the provisions of the False Claims Act, 31 U.S.C. 3729 et seq., for payment of an amount not less than that proposed.

(c) Where a final determination that the respondent presented or caused to be presented a claim and/or request for payment falling within the scope of § 101.102 has been rendered in any proceeding in which the respondent was a party and had an opportunity to be heard, the respondent shall be bound by such determination in any proceeding under this part.

(d) The respondent shall bear the burden of producing and proving by a preponderance of the evidence any circumstances described in § 101.106 that would justify reducing the amount of the penalty or assessment, or the period of suspension.

§ 101.115 Authority of ALJ.

(a) The ALJ will conduct a fair hearing, avoid delay, maintain order, and assure that a record of the proceeding is made.

(b) The ALJ shall have the authority to:

(1) Change the date, time, and place on the hearing, upon notice to the parties;

(2) Continue or recess the hearing in whole or in part for a reasonable period of time;

(3) Hold conferences to identify or simplify the issues, or to consider other matters that may aid in the expeditious disposition of the proceeding;

(4) Administer oaths and affirmations;

(5) Issue subpoenas in hearings involving Medicare claims;

(6) Rule on motions and other procedural matters;

(7) Regulate the course of the hearing and the conduct of counsel;

(8) Examine witnesses;

(9) Receive, rule on, exclude, or limit evidence;

(10) Upon motion of a party, decide cases, in whole or in part, by summary judgment where there is no disputed issue of material fact;

(11) Issue a written opinion containing findings of fact, conclusions of law, and an initial decision on whether a penalty or assessment or suspension should be imposed, and if so, the amount.

(c) The ALJ does not have the authority to decide upon the validity of Federal statutes or regulations.

(d)(1) The ALJ shall schedule a prehearing conference at a reasonable time in advance of the hearing, at which the parties or their counsel shall meet with the ALJ to consider:

(i) Simplification of the issues;

(ii) The necessity or desirability of amendments to pleadings for purposes of clarification, simplification, or limitation;

(iii) Stipulations, admissions of fact or the contents and authenticity of documents;

(iv) Limitation of the number of witnesses;

(v) Scheduling dates for the exchange of witness lists and of proposed exhibits; and

(vi) Such other matters as may tend to expedite the disposition of the proceedings.

(2) The ALJ shall issue an order containing all matters described in paragraph (d)(1) of this section agreed upon by the parties or ordered by the ALJ.

§ 101.116 Rights of parties.

(a) All parties may:

(1) Appear by counsel (or, in the case of a government agency, other authorized representative) in all hearing proceedings.

(2) Participate in any prehearing or posthearing conference held by the ALJ.

(3) Agree to stipulations as to facts which will be made part of the record.

(4) Make opening statements at the hearing.

(5) Present material evidence which is relevant to the issues at the hearing.

(6) Present witnesses who then must be available for cross-examination by all other parties.

(7) Present oral arguments at the hearing.

(8) Submit written briefs, proposed findings of fact, and proposed conclusions of law, after the hearing.

(b)(1) A party wishing to procure the appearance and testimony at the hearing of any person having personal knowledge of the matters in issue may serve on the person a notice to appear as witness. The notice shall set forth the time, date, and place at which the person is to appear for the purpose of giving testimony and the categories of documents the witness is to bring to the hearing, if any. A copy of the notice shall be filed with the ALJ and additional copies shall be served upon all parties.

(2)(i) In all hearings, it shall be the obligation of each party to produce for examination any person, along with such documents as may be requested, at the time and place, and on the date set forth in a notice to appear as witness, if that party has control over such person.

(ii) In hearings involving Medicare claims, a notice to appear as witness may be accompanied by an administrative subpoena. A party who desires the issuance of a subpoena shall, not less than 15 days prior to the time fixed for a hearing, file with the ALJ a written request therefor, designating the witness(es) or document(s) to be produced and describing the address and location thereof with sufficient particularity to permit such witness(es) or document(s) to be found. A subpoena issued under this section shall be in the name of the Secretary. The party requesting the subpoena shall pay the cost of service and the fees and the mileage of any witnesses so subpoenaed, as provided in 28 U.S.C. 1821. Subpoenas shall be served by the party requesting issuance in the manner provided in § 205(d) of the Act. A check for witness fees and mileage shall accompany the subpoena when served.

(3) A party or prospective witness may file an objection to notice to appear as witness or, in the case of a subpoena, a motion to quash within five days after the notice or subpoena is served, stating with particularity the reasons why the party should not be required to produce a requested witness or why the prospective witness should not be required to appear. Where the party serving the notice has reason to believe that the party being served is likely to refuse to produce the requested witness, that party may move for an order enforcing the notice to appear as witness. Upon the failure of any person to comply with a subpoena issued under this section, the Secretary shall institute enforcement proceedings before the appropriate district court pursuant to § 205(e) of the Act, unless in the judgment of the Secretary the enforcement of such subpoena would be inconsistent with law or the purposes of the Act.

§ 101.117 **Discovery.**

(a) Upon request of a party, the ALJ shall allow that party to inspect and copy all documents, unless privileged, relevant to the issues in the proceeding that are in the possession or control of the other party. Depositions, interrogatories, and other forms of discovery are not authorized except as provided for in § 101.117(b). Nothing in this section shall be construed as requiring the disclosure of internal government documents prepared in conjunction with the investigation or litigation of the case.

(b) In those cases in which the Inspector General intends to introduce the results of a statistical sampling study as evidence at the hearing pursuant to § 101.133, the Inspector General, upon request of the respondent, shall make available for desposition, the individual(s) responsible for conducting the statistical sampling study. Should respondent intend to introduce expert testimony to rebut the statistical sampling study at the hearing, the respondent shall, upon request of the Inspector General, make available for deposition the expert witness or witnesses who will be called to so testify at the hearing. Such depositions shall be conducted in accordance with Rules 28 and 30 of the Federal Rules of Civil Procedure. Such depositions may be used by an adverse party for any purpose at the hearing. The failure of a party to make witnesses available for deposition pursuant to this section shall serve to bar the introduction of testimony or other evidence from those witnesses at the hearing.

(c)(1) Witness lists, prior statements of witnesses, and hearing exhibits shall be exchanged at least 15 days in advance of the hearing, or such other later time as is set by the ALJ. Each party shall provide to the other party copies of all exhibits that it then plans to use at the hearing.

(2) All discovery shall be concluded at least 30 days prior to the hearing or by such other later time as ordered by the ALJ. The ALJ shall, however, allow adequate time for discovery.

§ 101.118 **Evidence and Witnesses.**

(a) Testimony at the hearing is given orally and under oath or affirmation. Written direct testimony may be used in the discretion of the ALJ. Witnesses must be available at the hearing for cross-examination by all parties.

(b) The parties may agree to stipulations of fact. Such stipulations, or any exhibit proposed by a party, must be exchanged at a prehearing conference or otherwise prior to the hearing, if the ALJ so decides.

(c) Technical rules of evidence are not applicable to the hearing, except that when reasonably necessary, the ALJ must apply rules or principles designed to assure production of the most credible evidence available and to subject testimony to test by cross-examination.

(d) A witness may be cross-examined on any matter relevent to the proceeding without regard to the scope of his or her direct examination.

(e) The ALJ shall exclude irrelevant, immaterial, or unduly repetitious evidence.

(f) All documents and other evidence offered or taken for the record shall be open to examination by the parties.

§ 101.119 **Exclusion from the hearing for misconduct.**

Disrespectful or disorderly language or conduct, refusal to comply with directions, or continued use of dilatory tactics by any individual at the hearing constitutes grounds for immediate exclusion of that individual from the hearing by the ALJ.

§ 101.120 **Ex parte contacts.**

(a) Except for matters related to the issuance of ex parte subpoenas, the ALJ may not consult or be consulted by a party or any other individual (except employees of his own office) on any matter in issue, unless on notice and opportunity for all parties to participate.

(b) The ALJ shall not consider letters or other contacts from non-parties expressing views or urging action.

§ 101.121 **Separation of functions.**

An employee or an agent of the Department, who is engaged in the performance of investigative or prosecutive functions for or on behalf of the Department in a case may not, in that or a factually related case, participate or advise in the decision, except as witness or counsel in public proceedings.

§ 101.122 **Official transcript.**

The hearing will be recorded and transcribed. Transcripts may be obtained from the reporter by a party or the public at not to exceed the maximum rates fixed by contract between the Department and the reporter.

§ 101.123 **Post-hearing briefs.**

The ALJ shall fix the time for filing post-hearing briefs, which shall not exceed 30 days from the date of receipt of the hearing transcript by the parties. Upon motion by a party, the ALJ may extend the time in which to file post-hearing briefs for a period of up to 60 days where the hearing was of unusual length or complexity or for other good cause shown. Such briefs may contain proposed findings of fact and conclusions of law. The ALJ may permit the parties to file reply briefs.

§ 101.124 Record for decision.

The transcript of testimony, exhibits, and all papers, requests and rulings filed or made in the proceedings, constitute the exclusive record for the ALJ's initial decision.

§ 101.125 Initial decision; administrative review; finality.

(a) The ALJ shall serve the initial decision on all parties within 60 days after the time for submission of post-hearing briefs and reply briefs (if permitted) has expired.

(b) The initial decision shall contain findings of fact, conclusions of law, and the amount of any penalties and assessments (which may be the amount proposed by the Inspector General, or a greater or lesser amount), and the length of any suspension (which may be for the period proposed by the Inspector General, or a greater or lesser period of time), imposed upon the respondent thereby.

(c) The findings of fact shall include a finding on each of the following issues for every item or service with respect to which a penalty or assessment was proposed:

(1) Whether the item or service is subject to a determination under § 101.102, and

(2) If the item or service is subject to a determination under § 101.102 whether there are mitigating or aggravating circumstances as described in § 101.106(b).

(d) The initial decision of the ALJ becomes final and binding on the parties 30 days after notice thereof is received by the respondent, unless on or before that 30th day a party files with the ALJ written exception to the initial decision and supporting reasons for the exceptions.

(e) A party opposing exceptions may file a brief in opposition to exceptions within 30 days after receipt of the exceptions or may file a brief which is limited to the issue of whether or not the Secretary should review the initial decision of the ALJ.

(f)(1) If a party timely files exceptions under paragraph (d) of this section, the ALJ will forward to the Secretary the record of the proceeding, the exceptions and reasons therefor, and any briefs filed in opposition.

(2) After the Secretary receives the initial decision, the record on which it is based, and submissions of the parties made subsequent to the decision, the Secretary will determine whether or not he will review the initial decision of the ALJ.

(3) In any case in which the Secretary decides to review the initial decision of the ALJ, he will inform each party of his decision by written notice. A party opposing exceptions may file a brief addressing any relevant issues not addressed in any brief filed under paragraph (e) of this section within 30 days after receipt of the Secretary's written notice under this paragraph. After the Secretary has reviewed the initial decision, the record on which it is based, and submissions of the parties made subsequent to the decision, the Secretary will affirm, modify, or reverse the initial decision, or remand the case to an ALJ. The Secretary may modify the penalty, assessment, or suspension, to be more or less severe than that imposed by the ALJ. There is no right to appear personally before the Secretary. A copy of the decision of the Secretary will be sent to the respondent by certified mail, mailed return receipt requested, and served upon the Inspector General. Except in the case of a remand, the decision of the Secretary becomes final and binding on the parties 60 days after notice thereof is received by the respondent.

(4) In any case in which the Secretary declines to review the initial decision of the ALJ, he will notify the respondent by certified mail, return receipt requested, and inform the Inspector General of his decision. The initial decision of the ALJ becomes final and binding on the parties 60 days after the Secretary's notice is received by the respondent.

(5)(i) The respondent may file with the ALJ a request for stay of the effective date of the final decision pending appeal. Such request shall state the grounds upon which respondent relies in requesting the stay, together with a copy of the notice(s) of appeal filed by respondent seeking review of the decision of the Secretary. The filing of such a request shall automatically act to stay the effective date of the decision of the Secretary until such time as the ALJ rules upon the request.

(ii) The Inspector General may file an opposition to respondent's request for a stay within 10 days of receipt of the request. If the Inspector General fails to file such an opposition within the allotted time, or indicates that he has no objection to the request, the ALJ shall grant the stay without requiring respondent to give a bond or other security.

(iii) In those cases in which the Inspector General opposes respondent's request for a stay, the ALJ may grant respondent's request where justice so requires and to the extent necessary to prevent irreparable harm. An ALJ may grant an opposed request to stay a final decision requiring the payment of money only upon the respondent's giving of a bond or other adequate security. The ALJ shall rule upon an opposed request for stay within 10 days of the receipt of the opposition of the Inspector General. A decision of the ALJ denying respondent's request for a stay shall constitute final agency action.

§ 101.126 Settlement.

The Inspector General has exclusive authority to settle any issues or case, without the consent of the ALJ or the Secretary, at any time prior to a final decision by the Secretary. Thereafter, the General Counsel has such exclusive authority.

§ 101.127 Judicial review.

(a) Section 1128A(d) of the Act authorizes judicial review of a penalty or assessment imposed under §§ 101.110 or 101.125 that has become final. Judicial review may be sought by a respondent only with respect to a penalty or assessment with respect to which the respondent filed an exception under § 101.125(d) unless the failure or neglect to urge such exception shall be excused by the court pursuant to section 1128(A) because of extraordinary circumstances.

(b) Section 1128(d) of the Act authorizes judicial review of a determination to bar a person from participation in Medicare or Medicaid pursuant to 1128(b) of the Act. Judicial review may be sought by a respondent only with respect to a suspension with respect to which the respondent filed an exception under § 101.125(d) unless the failure or neglect to urge such exception shall be excused because of extraordinary circumstances.

§ 101.128 Collection of penalty and assessment.

(a) Once a determination by the Secretary has become final under § 101.125(f), collection of any penalty and assessment shall be the responsibility of HCFA, except in the case of the Maternal and Child Health Services Block Grant, where the collection shall be the responsibility of the Public Health Service.

(b) A penalty and assessment imposed under this part may be compromised by the General Counsel, after consultation with the Inspector General, and may be recovered in a civil action brought in the United States district court for the district where the claim was presented, or where the respondent resides.

(c) The amount of a penalty and assessment when finally determined, or the amount agreed upon in compromise, may be deducted from any sum then or later owing by the United States, or by a State agency, to the respondent.

(d) Matters that were raised or that could have been raised in a hearing before an ALJ or in an appeal under section 1128A(d) of the Act may not be raised as a defense in a civil action by the United States to collect a penalty under this part.

§ 101.129 Notice to other agencies.

Whenever a penalty and assessment or suspension imposed under this part becomes final, HCFA and the Public Health Service will notify the appropriate State or local medical or professional association, the appropriate Professional Standards Review Organization, the State Medicaid agency, the appropriate Medicare carrier or intermediary, the appropriate State or local licensing agency or organization (including the Medicare and Medicaid State survey agencies), the long-term care ombudsman, and where appropriate, the State agency administering a Maternal and Child Health Services Block Grant Program, that the penalty and assessment or suspension have become final and the reasons for them. In cases involving suspensions, HCFA will also give notice to the public of the suspension and its effective date. HCFA will also provide to the State Medicaid agency the notice required under section 1128(b) of the Social Security Act.

§ 101.130 Form, filing and service of papers; computation of time; Motions, disposition of motions.

(a) *Form, filing and service of papers*—(1) *Form.* The original and one copy of all papers in a proceeding conducted under this part shall be filed with the ALJ assigned to the case or with the Chief ALJ if the case has not been assigned. Every pleading and paper filed in the proceeding shall contain a caption setting forth the title of the action, the case file number assigned by the ALJ, and a designation of the paper (e.g., motion for summary judgment). The paper shall be signed and shall contain the address and telephone number of the person representing the party or the person on whose behalf the paper was filed. Unless the ALJ otherwise orders with respect to specific papers in a specific case, all such papers are public documents. Papers are considered filed when they are received by the ALJ.

(2) *Service.* Service upon any party shall be made by the party filing the document by delivering or mailing a copy to the party's last known address. When a party is represented by an attorney, service shall be made upon the attorney.

(3) *Proof of service.* A certificate of the person serving the document by personal delivery or by mailing, setting forth the manner of sevice, shall be proof of service.

(b) *Computation of Time.* In computing any period of time under these rules or in an order issued hereunder, the time begins with the day folowing the act, event, or default, and includes the last day of the period, unless it is a Saturday, Sunday, or legal holiday observed by the Federal government, in which event it includes the next business day. When the period of time allowed is less than seven days, intermediate Saturdays, Sundays and legal holidays observed by the Federal government shall be excluded from the computation.

(c) *Motions, disposition of motions*—(1) *Motions.* Motions shall state the relief sought, the authority relied upon and the facts alleged, and shall be filed with the ALJ. If made before or after the hearing itself, the motions shall be in writing. If made at the hearing, motions may be stated orally; bu the ALJ may require that they be reduced to writing and filed and served on all parties in the same manner as a formal motion. Unless otherwise ordered by the ALJ, written motions shall be accompanied by a supporting memorandum. Within 10 days after a written motion is served, or such other time period as may be fixed by ALJ, any party may file a response to a motion.

(2) *Disposition of motions.* The ALJ may not grant a written motion prior to expiration of the time for filing responses thereto, except upon consent of the parties or following a hearing, but may overrule or deny such motion without awaiting response. The ALJ shall make every reasonable effort to dispose of all outstanding motions prior to the beginning of the hearing.

§ 101.131 Records to be public.

All documents contained in the records of formal proceedings for imposing a penalty and assessment or suspension under this part may be inspected and copied, unless ordered sealed by the ALJ.

§ 101.132 Limitations.

No action under this part shall be entertained unless commenced, pursuant to § 101.109(a) of this part, within five years from the date on which the right of action accrued.

§ 101.133 Statistical sampling.

(a) In meeting the burden of proof set forth in § 101.114, the Inspector General may introduce the results of a statistical sampling study as evidence of the number and amount of claims and/or requests for payment as described in § 101.102 that were presented or caused to be presented by respondent. Such as statistical sampling study, if based upon an appropriate sampling and computed by valid statistical methods, shall constitute prima facie evidence of the number and amount of claims or requests for payment as described § 101.102.

(b) Once the Inspector General has made a prima facie case as described in paragraph (a) of this section, the burden of production shall shift to respondent to produce evidence reasonably calculated to rebut the findings of the statistical sampling study. The Inspector General will then be given the opportunity to rebut this evidence.

Approved: July 27, 1983.

Margaret M. Heckler,

Secretary.

[FR Doc. [illegible] Filed [illegible]]

BILLING CODE [illegible]

DEPARTMENT OF TRANSPORTATION

National Highway Traffic Safety Administration

49 CFR Part 571

[Docket No. 71-3a; Notice 7]

Federal Motor Vehicle Safety Standards; Rearview Mirror Systems

AGENCY: National Highway Traffic Safety Administration (NHTSA), DOT.

ACTION: Final rule and response to petitions.

SUMMARY: This notice responds to a petition for reconsideration filed by Volkswagen of America regarding a recent amendment to Federal Motor Vehicle Safety Standard (FMVSS) 111, and to a related petition for rulemaking filed by Toyota Motor Corporation. The amendment to FMVSS 111 permitted the use of exterior passenger side convex mirrors on passenger cars and trucks, multipurpose passenger vehicles and buses other than schoolbuses with a gross vehicle weight rating of 10,000 pounds or less to meet the field of view requirements of that standard. The amendment required that such convex mirrors must have "indelibly etched" on the mirror's surface the warning "Objects in Mirror Are Closer Than They Appear." The amendment also specified a maximum radius of curvature requirement for such mirrors. The agency is denying Volkswagen requests that the warning and maximum radius requirements be deleted, but in

(d) Matters that were raised or that could have been raised in a hearing before an ALJ or in an appeal under section 1128A(d) of the Act may not be raised as a defense in a civil action by the United States to collect a penalty under this part.

§ 101.129 Notice to other agencies.

Whenever a penalty and assessment or suspension imposed under this part becomes final, HCFA and the Public Health Service will notify the appropriate State or local medical or professional association, the appropriate Professional Standards Review Organization, the State Medicaid agency, the appropriate Medicare carrier or intermediary, the appropriate State or local licensing agency or organization (including the Medicare and Medicaid State survey agencies), the long-term care ombudsman, and where appropriate, the State agency administering a Maternal and Child Health Services Block Grant Program, that the penalty and assessment or suspension have become final and the reasons for them. In cases involving suspensions, HCFA will also give notice to the public of the suspension and its effective date. HCFA will also provide to the State Medicaid agency the notice required under section 1128(b) of the Social Security Act.

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(b) *Computation of Time.* In computing any period of time under these rules or in an order issued hereunder, the time begins with the day folowing the act, event, or default, and includes the last day of the period, unless it is a Saturday, Sunday, or legal holiday observed by the Federal government, in which event it includes the next business day. When the period of time allowed is less than seven days, intermediate Saturdays, Sundays and legal holidays observed by the Federal government shall be excluded from the computation.

(c) *Motions, disposition of motions*—(1) *Motions.* Motions shall state the relief sought, the authority relied upon and the facts alleged, and shall be filed with the ALJ. If made before or after the hearing itself, the motions shall be in writing. If made at the hearing, motions may be stated orally; bu the ALJ may require that they be reduced to writing and filed and served on all parties in the same manner as a formal motion. Unless otherwise ordered by the ALJ, written motions shall be accompanied by a supporting memorandum. Within 10 days after a written motion is served, or such other time period as may be fixed by ALJ, any party may file a response to a motion.

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(b) Once the Inspector General has made a prima facie case as described in paragraph (a) of this section, the burden of production shall shift to respondent to produce evidence reasonably calculated to rebut the findings of the statistical sampling study. The Inspector General will then be given the opportunity to rebut this evidence.

Approved: July 27, 1983.

Margaret M. Heckler,

Secretary.

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DEPARTMENT OF TRANSPORTATION

National Highway Traffic Safety Administration

49 CFR Part 571

[Docket No. 71-3a; Notice 7]

Federal Motor Vehicle Safety Standards; Rearview Mirror Systems

AGENCY: National Highway Traffic Safety Administration (NHTSA), DOT.

ACTION: Final rule and response to petitions.

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July 29, 1985

William S. Cohen, Chairman
United States Senate
Subcommittee on Oversight of
  Government Management
Washington, D.C. 20510

Dear Senator Cohen:

As you are perhaps aware, Rhett Dawson has resigned from our firm to take a position as Executive Director of the Packard Commission on Defense Management. The attached Supplemental Statement was prepared by Mr. Dawson before his departure and after his testimony before the Subcommittee in response to questions posed by you and by Senator Levin. At this time, on behalf of the Aerospace Industries Association, I would like to submit the attached Supplemental Statement for the hearing record. I hope it clarifies Mr. Dawson's prior testimony.

If I can be of any further assistance to the Subcommittee on this issue, please do not hesitate to contact me.

Sincerely,

Paul R. Taskier

Paul R. Taskier

Attachment

Supplemental Statement
of Rhett Dawson
On behalf of the Aerospace Industries
Association of America, Inc. before
the Committee on Governmental Affairs
of the United States Senate,
Subcommittee on Oversight
of Government Management

Regarding the "Program Fraud Civil
Penalties Act of 1985" S. 1134

During the hearing before the Committee on June 18, 1985, the Committee asked questions regarding the standard of knowledge or intent required under the bill's language of "know or has reason to know." Again, it should be emphasized that only general intent was referred to in the previous submitted statement. Specific intent, as that phrase is used in the criminal law, was not relied upon. Our review of the cases supports that interpretation. Indeed, the written statement of Mr. Vander Schaaf, at page 7, endorses the bill's knowledge standard as a general intent provision, noting that specific intent is not encompassed by this knowledge standard. Mr. Vander Schaaf also stated, "this general intent standard has general acceptability in civil cases litigated under the False Claims Act and in administrative matters."

With regard to the degrees of knowledge defined by the term "has reason to know", the Committee discussed questions of conscious insulation, of gross negligence, of reckless disregard, and of "playing ostrich". We believe that the definition of "reason to know" supplied by the Restatements (Second) of Agency and of Torts accurately and appropriately describes the area this knowledge standard is meant to encompass. See Sanders v. United States, 509 F.2d 162, 167 (5th Cir. 1975); Fidler v. Eastman Kodak Co., 555 F. Supp. 87, 91-92 (D. Mass. 1982); Christians v. Homestake Enterprises, Ltd., 303 N.W.2d 608, 619 (Wis. 1981); Von Gohren v. Pacific National Bank of Washington, 505 P.2d 467, 472 (Wash. App. 1973). See also, e.g., United States v. Precision Medical Laboratories, 593 F.2d 434, 443-44 (2d Cir. 1978); United

States v. Cook, 586 F.2d 572, 579-80 (5th Cir. 1978); United States v. Restrepo-Granda, 575 F.2d 524, 528-29 (5th Cir. 1978); United States v. Evans, 559 F.2d 244, 246 (5th Cir.), cert. denied, 434 U.S. 1015 (1978); United States v. Jacobs, 475 F.2d 270, 287-88 (2d Cir. 1973); United States v. Featherston, 461 F.2d 1119 (5th Cir. 1972); United States v. Sarantos, 455 F.2d 877, 881-83 (2d Cir. 1972). "'[R]eason to know' imports no duty to ascertain facts not to be deduced as inferences from facts already known; one has reason to know a fact only if a reasonable person in his position would infer such fact from other facts already known to him." Thus, as posited by the Committee, liability under the Act could be found in numerous situations.

Plainly, if one has actual knowledge of a false statement or false claim, liability accrues. As noted during the hearing, the "reason to know" standard is more fact-specific. If a contractor actually told his subordinates not to inform him of any false statements or claims, so as to circumvent the knowledge standard, that conscious attempt at insulation would be the fact from which the contractor could infer the falsity of a statement or claim. Thus, by reason of this conscious act of insulation, a contractor would have "reason to know" of a false statement or false claim.

The converse is also true. If a contractor submitting a claim or statement had not made any such conscious effort to insulate himself, and if there is no evidence of a culpable avoidance of facts regarding the falsity of claims or statements, then the contractor does not have "reason to know" because from the facts known to him he would not be able to infer the falsity of a claim or statement. The "knows or has reason to know" standard of knowledge thus imparts a general intent to make a false statement or claim.

In order to find liability under the bill, it must be determined on the particular facts of each case whether the submittor of the statement or claim "knew or had reason to know" that the statement or claim was false. This requirement is inescapably fact-specific when the concepts of "gross negligence" or "reckless disregard" are discussed. Whether a contractor was grossly negligent or acting recklessly in submitting a claim or statement is a determination that can only be made from a review of the particular facts. Someone who submits a statement or claim without having read it may be grossly negligent so as to find an intent to make a false claim or statement. Alternatively, a personal detailed review of intricate and complex proposals prepared by qualified and professional subordinates would probably not constitute gross negligence or reckless disregard as there are elements of reliance upon the correctness of the subordinates' determinations and because, if the facts so warrant, there is no "reason to know" that facts may be false.

This is concededly a difficult area, but as we noted, it is an area that the law has addressed and in which it has formulated certain standards that are appropriately referred to in different factual contexts. We believe that every investigation or prosecution under the Program Fraud Civil Penalties Act of 1985 will present a different set of facts under which to determine whether the persons who submitted a claim or statement "knew or had reason to know" that the claim or statement was false. As we have attempted through our testimony to present, we believe that the analysis and definitions used in the Restatements (Second) of Agency and of Torts reflect the state of the law as it is in the majority of jurisdictions and as it indeed should be. We respectfully suggest that the Committee make plain that the "know or has reason to know" standard should be interpreted in accordance with the analysis outlined in the Restatements (Second) of Agency and of Torts by so many distinguished scholars and jurists.

U. S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

OFFICE OF THE INSPECTOR GENERAL

CIVIL MONETARY PENALTIES

A LEGAL, INVESTIGATIVE AND PROCEDURAL GUIDE TO THE CIVIL MONETARY PENALTIES LAW OF 1981

RICHARD P. KUSSEROW
INSPECTOR GENERAL

JUNE 1982

INTRODUCTION

This publication is intended to be an introduction to the Civil Monetary Penalties Law of 1981, Section 1128A of the Social Security Act, and related statutes, in particular the False Claims Act (Civil Fraud), 31 USC 231.

Section 1128A is codified as 42 USC 1320a - 7a. It pertains to the presenting of certain false or improper claims and provides for a civil monetary penalty of "not more than $2,000" and an assessment of "not more than twice the amount claimed for each item or service in lieu of damages sustained by the United States or a State agency because of such claim."

The statute is too new for there to be any direct legal precedent or specific guidelines. However, a study and comparison of the provisions of the Civil Monetary Penalties Law (CMPL) and the False Claims Act (FCA) show substantial similarities in language and intent. It is likely, therefore, that the precedent built up behind the FCA, which was passed in 1863, will provide substantial support in cases involving the CMPL.

An inventory of CMPL cases is being developed. In the interim, cases will be processed under FCA for referral to the Department of Justice (DOJ).

It is important for us to become familiar with the FCA and its history, as well as with the CMPL, and a comparison of the analogous language of the related statutes is included. Of necessity, the discussion relating to potential questions and problems which may arise under the CMPL is based on cases and other materials relating to the FCA.

Additional information was drawn from publications from DOJ, the Health Care Financing Administration (HCFA), and the Internal Revenue Service (IRS).

I. CIVIL MONETARY PENALTIES LAW OF 1981, SECTION 1128A OF THE SOCIAL SECURITY ACT [42 USC 1320a - 7a]

Provisions of the Civil Monetary Penalties Law

Under the Omnibus Budget Reconciliation Act: "Section 2015(a)"

Part A of Title XI of the Social Security Act is amended by inserting after section 1128 the following new section:

"CIVIL MONETARY PENALTIES"

"Section 1128A. (a) Any person (including an organization, agency, or other entity that presents or causes to be presented to an officer, employee, or agent of the United States, or of any department or agency thereof, or of any State agency (as defined in subsection (h)(1)), a claim (as defined in subsection (h)(2)) that the Secretary determines--

"(1) is for a medical or other item or service--

"(A) that the person knows or has reason to know was not provided as claimed, or

"(B) payment for which may not be made under the program under which such claim was made, pursuant to a determination by the Secretary under section 1128, 1160(b), 1862(d), or 1866(b)(2), or

"(2) is submitted in violation of an agreement between the person and the United States or a State agency,

shall be subject, in addition to any other penalties that may be prescribed by law, to a civil money penalty of not more than $2,000 for each item or service. In addition, such a person shall be subject to an assessment of not more than twice the amount claimed for each such item or service in lieu of damages sustained by the United States or a State agency because of such claim (emphasis added).

"(b)(1) The Secretary may initiate a proceeding to determine whether to impose a civil money penalty or assessment under the subsection (a) only as authorized by the Attorney General pursuant to procedures agreed upon by them.

"(2) The Secretary shall not make a determination adverse to any person under subsection (a) until the person has been given written notice and an opportunity for the determination to be made on the record after a hearing at which the person is entitled to be represented by counsel, to present witnesses, and to cross-examine witnesses against the person.

"(c) In determining the amount or scope of any penalty or assessment imposed pursuant to subsection (a), the Secretary shall take into account--

"(1) the nature of claims and the circumstances under which they were presented,

"(2) the degree of culpability, history of prior offenses, and financial condition of the person presenting the claims, and

"(3) such other matters as justice may require.

"(d) Any such person adversely affected by a determination of the Secretary under this section may obtain a review of such determination in the United States Court of Appeal for the circuit in which the person resides, or in which the claim was presented, by filing in such court (within sixty days following the date the person is notified of the Secretary's determination) a written petition requesting that the determination be modified or set aside. A copy of the petition shall forthwith be transmitted by the clerk of the court to the Secretary, and thereupon the Secretary shall file in the Court the record in the proceeding as provided in section 2112 have jurisdiction of the proceeding and of the question determined therein, and shall have the power to make and enter upon the pleadings, testimony, and proceedings set forth in such record a decree affirming, modifying, remanding for further consideration, or setting aside, in whole or in part, the determination of the Secretary and enforcing the same to the extent that such order is affirmed or modified. No objection that has not been urged before the Secretary shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. The findings of the Secretary with respect to questions of fact, if supported by substantial evidence on the record considered as a whole, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for the failure to adduce such evidence in the hearing before the Secretary, the court may order such additional evidence to be taken before the Secretary and to be made a part of the record. The Secretary may modify his findings as to the facts, or make new findings, by reason of additional evidence so taken and filed, and he shall file with the court such modified or new findings, which findings with respect to questions of fact, if supported by substantial evidence on the record considered as a whole, shall be conclusive, and his recommendations, if any, for the modification or setting aside of his original order. Upon filing of the record with it, the jurisdiction of the court shall be exclusive and its judgment and decree shall be final, except that the same shall be subject to review by the Supreme Court of the United States, as provided in section 1254 of title 28, United States Code.

"(e) Civil money penalties and assessment imposed under this section may be compromised by the Secretary and may be recovered in a civil action in the name of the United States brought in United States district court for the district where the claim was presented, or where the claimant resides, as determined by the Secretary. Amounts recovered under this section shall be paid to the Secretary and disposed of as follows:

"(1)(A) In the case of amounts recovered arising out of a claim under title XIX, there shall be paid to the State agency an amount equal to the State's share of the amount paid for such claim.

"(B) In the case of amounts recovered arising out of a claim under an allotment to a State under title V, there shall be paid to the State agency an amount equal to three-sevenths of the amount recovered.

"(2) Such portion of the amounts recovered as is determined to have been paid out of the trust funds under sections 1817 and 1841 shall be repaid to such trust funds.

"(3) The remainder of the amounts recovered shall be deposited as miscellaneous receipts of the Treasury of the United States.

The amount of such penalty or assessment, when finally determined, or the amount agreed upon in compromise, may be deducted from any sum then or later owing by the United States or a State agency to the person against whom the penalty or assessment has been assessed.

"(f) A determination by the Secretary to impose a penalty or assessment under subsection (a) shall be final upon the expiration of the sixty-day period referred to in subsection (d). Matters that were raised or that could have been raised in a hearing before the Secretary or in an appeal pursuant to subsection (d) may not be raised as a defense to a civil action by the United States to collect a penalty or assessment assessed under this section.

"(g) Whenever the Secretary's determination to impose a penalty or assessment under subsection (a) becomes final, he shall notify the appropriate State or local medical or professional organization, and the appropriate Professional Standards Review Organization, and the appropriate State or local licensing agency or organization (including the agency specified in section 1864(a) and 1902(a)(33)) that such a penalty or assessment has become final and the reasons therefor.

"(h) For the purposes of this subsection:

"(1) The term 'State agency' means the agency established or designated to administer or supervise the administration of the State plan under title XIX of this Act [Medicaid] or designated to administer the State's program under title V of this Act [Maternal and Child Health and Crippled Children's Services Program].

"(2) The term 'claim' means an application submitted by--

"(A) a provider of services or other person, agency, or organization that furnished an item or service under title XVIII of this Act [Medicare], or

"(B) a person, agency, or organization that furnishes an item or service for which medical assistance is provided under title XIX of this Act [Medicaid], or

"(C) a person, agency, or organization that provides an item or service for which payment is made under title V of this Act or from an allotment to a State under such title, to the United States or a State agency, or agent thereof, for payment for health care services under title XVIII or XIX of this Act or for any item or service under title V of this Act.

"(3) The term 'item or service' includes (A) any particular item, device, medical supply, or service claimed to have been provided to a patient and listed in an itemized claim for payment, and (B) in the case of a claim based on costs, any entry in the cost report, books of account or other documents supporting such claim.

"(4) The term 'agency of the United States' includes any contractor acting as a fiscal intermediary, carrier, or fiscal agent or any other claims processing agent for a health insurance or medical services program under title XVIII or XIX of this Act.".

(b) Section 1128 of such act is amended--

(1) by striking out ", for such period as he may deem appropriate," in subsection (a)(1),

(2) by striking out "subsection (a)" in subsection (c) and inserting in lieu thereof "subsection (a) or (b)",

(3) by redesignating subsections (b) and (c) as subsections (c) and (d), respectively, and

(4) by inserting after subsection (a) the following new subsection:

"(b) Whenever the Secretary makes a final determination to impose a civil money penalty or assessment against a person (including an organization, agency, or other entity under section 1128A relating to a claim under title XVIII or XIX, the Secretary--

"(1) may bar the person from participation in the program under title XVIII, and

"(2)(A) shall promptly notify each appropriate State agency administering or supervising the administration of a State plan approved under title XIX of the fact and circumstances of such determination, and (except as provided in subparagraph (B)) may require each such agency to bar the person from participation in the program established by such plan for such period as he shall specify, which in the case of an individual shall be the period established pursuant to paragraph (1), and

"(B) may waive the requirement of subparagraph (A) to bar a person from participation in such program where he receives and approves a request for such waiver with respect to that person from the State agency referred to in that subparagraph.".

(c) Section 1902(a)(39) of such Act is amended by striking out "individual" and inserting in lieu thereof "person" each place it appears.

II. THE FALSE CLAIMS ACT
CIVIL FRAUD, 31 USC 231

Up to now, the FCA has been the primary weapon used to recover damages resulting from fraud against the government. Simply put, it provides that any person who submits a false statement to obtain payment or submits a false claim for payment, or who conspires to defraud the United States, shall be liable for double damages and $2,000 per claim.[1]

A. Definition of "Persons"

"Persons" under the FCA include corporations, companies, partnerships, societies and like groups, in addition to individuals. Persons in the Armed Forces are not covered.

The legal theory of "respondeat superior" makes a corporation liable for the fraudulent acts of its officers and employees acting within the scope of their authority. The general rule in criminal cases is that if a specific criminal intent is necessary to constitute a crime, an employer may be penalized for an employee's criminal act only if the agent acted within the scope of his employment, and not if the agent acted for some purpose other than that of serving his employer.[2]

The traditional and still predominant test in most jurisdictions is whether the acts were within the person's scope of employment and/or were done under color of authority of the person's position. If so, the institution may also be liable. For example, if the employee's job was to obtain financial information from a patient for submission to the government via a Medicaid claim and the employee substituted false information, it was done in the scope of his employment.

Imposition of liability on an employer in an action to recover damages has three basic rationales:

1. The third party reasonably thought the agent was acting for the employer;
2. Imposition of liability encourages more careful supervision of employees by employer; and
3. The third person has suffered a loss which the employer is better able to bear than is his agent.[3]

In most civil cases the employer has been held liable for the fraudulent misrepresentations of his agent, even though the agent acted without any intent to benefit his employer, so long as the third party reasonably believed that the agent was acting within the scope of his employment.[4]

The Fifth Circuit did not follow the general rule and refused to apply FCA forfeitures and double damages where a bank officer acted without anyone else's knowledge and without any purpose of benefiting the bank.[5] In effect, the Circuit has added a requirement that the action must be for the purpose of benefiting an entity.

As to its first function, which is retrospective, there is a difference "between a situation where the claimant is fraudulently demanding money and one where he is fraudulently seeking a reduction in the amount of money to be paid by him."[10] This "fraudulent reduction of [a person's] liability to the government does not spell out a false claim as defined by the statute," although it might constitute a "false statement" within the meaning of 18 USC 1001.

When the cost report is used prospectively, it is clear that its submission would constitute a "claim" under recognized definitions.

C. Federal Character of Funds

Often the United States grants money to agencies on the state or local level. When a fraud is perpetrated on such an agency, it must be determined if the United States maintains sufficient control and/or interest over the grant funds so that the money retains its Federal character.[11] If such control or interest is present, the fraud violated both Federal and state criminal and civil statutes. Otherwise, the fraud remains a state violation but cannot be the subject of a Federal prosecution or lawsuit, since the funds were no longer Federal money.

As to Medicaid claims, for example, there is no question that claims submitted to a state fiscal intermediary qualify as "claims" because of the substantial contacts with the Federal government. Disbursements to states are subject to a myriad

As to the liability of an organization, e.g., corporation, etc., it is usually the combined knowledge of the employees which is attributed to the organization. This means that not every employee of an organization need to know that a fraud is being committed against the government. It is sufficient if only one or some of the employees know. Where one or more persons acted in concert with another person or entity, their liability is joint and several, and each is liable for the entire amount of the damages. Just as the knowledge of a corporate employee is attributed to the corporation, the knowledge of an agent is attributed to his principal.

B. Definition of "Claims Against the Government"

In general, a claim is a demand for the payment of government money or the transfer of government property. The FCA extends not only to legally enforceable claims but to "all fraudulent attempts to cause the government to pay out sums of money."[6]

The definition of a claim within the purview of the FCA often depends upon the government program involved. The program, therefore, must be understood and set forth in each case. For instance, applications for government guarantee of loans are not claims because the United States promises to pay only in event of default. However, if the borrower defaults and the lender calls upon the government to make good on its guarantee, a claim is thereby submitted. Investigations should, therefore, include information about whether such loans have gone into default.

The objective of Congress in enacting the FCA was "broadly to protect the funds and property of the government from fraudulent claims, regardless of the particular form or function of the government's instrumentality upon which such claims were made."[7] By any ordinary standard, the language is certainly comprehensive enough to achieve this purpose so that the FCA reaches beyond 'claims' which might be legally enforced, to all fraudulent attempts to cause the government to pay out sums of money.[8] For example, a grain storage bin dealer's preparation of invoices overstating the purchase price of storage bins sold by it to certain farmers for the purpose of fraudulently inducing the Commodity Credit Corporation to extend greater credit than it otherwise was permitted to do so, constitutes a "claim" within the meaning of the FCA, which renders civilly liable those who make false claims against the United States.[9]

Cost reports from hospitals, nursing homes, etc., present an interesting question. They perform two basic functions. First, they recap expenses for a previous fiscal period and, depending on how much money has already been advanced, can result in either an additional outlay of Federal funds or the return of funds already advanced back to the government. This can be done either directly or by offset against funds authorized but not yet provided by the government. Second, they provide the legal and financial basis for providing funds for a succeeding fiscal period.

of Federal regulations and reporting requirements. Taken together, they constitute "persuasive evidence" that claims filed under the state program should be considered claims against the United States within the meaning of the FCA.[12]

As to Medicare, even when specified private insurance companies are empowered to process and pay Medicare claims in return for Federal reimbursement for claims paid and administrative costs, the claims do constitute claims against the United States.[13]

Any overcharge in a Medicaid-type program does result in an impairment of the Federal treasury because the government expends money that it would not expend but for the overcharge. Other cases also recognize the applicability of the FCA to State Medicaid programs.

As to the Maternal and Child Health Services program, there are no reported decisions but the dominant line of cases indicates that such claims would almost certainly be considered "claims against the Federal government." Several cases indicate that the United States Supreme Court has "adopted a liberal interpretation of the [False Claims] Act."[14]

If this point is in issue, questions which must be resolved in the investigative report include:

1. Is Federal approval required prior to spending the money? Was any kind of application sent to the government regarding this specific program activity or expenditure?

2. Does any surplus return to the Federal government?
3. Does any year-end surplus affect the next year's appropriation?
4. Was any kind of bidding process done as a Federal requirement or under Federal regulations?
5. Do Federal regulations or grant terms apply to the activity or expenditure?
6. Did payment come from a joint local-Federal bank account? Were Federal monies isolated from state or local funds--in separate bank accounts, in separate accounting records?

D. Presentation of Claims

Claims usually are in writing and are "presented" when put into the possession of an appropriate Federal employee or agent. For example, a subcontractor inflates his bill and the bill is later included in a prime contractor's invoice to a procurement officer. The submission of the invoice from the prime contractor constitutes the claim, but the subcontractor caused the claim to be submitted to the government and would be liable. A mortgagor submits a claim when he asks for payment on a VA home guarantee, but the person who originally submitted false statements in the application for the guarantee caused the claim to be submitted. Similarly, one who fraudulently endorses a government check causes a claim to be submitted when the bank later submits the check to the Treasury for collection.

E. Knowledge and Intent

1. Knowledge

This subject is treated in several distinct ways by the various jurisdictions. Some circuits accept constructive knowledge and hold that negligence or reckless disregard for the truth constitutes "knowledge" sufficient to justify liability under the FCA.[15] Other circuits require a showing of actual knowledge of the falsity or other impropriety of the claim.[16] The predominant view in most circuits requires actual "knowledge."

Direct evidence of "knowledge" is preferable but it can also be proved by circumstantial evidence, i.e., inferred from the circumstances.

In one case the Court of Appeals reasoned that since the FCA is civil in nature [as is the CMPL] the definition of "knowledge" to be used should be the same as in other civil matters dealing with representations and misrepresentations. It held that "the intent to deceive of a fraudulent misrepresentation may include a reckless disregard for the truth or falsity of a belief." The court reasoned that "...a tolerant attitude toward this practice could well evade and defeat the entire... program [since]... the whole program is based on fair and correct disclosure of basic facts."[17] This minority view has not been widely followed.

In a Medicare case claims were submitted falsely, indicating that services had been rendered by a physician. The claims were prepared and submitted by nursing home employees at the instruction of the nursing home operator. The physician, whose name was on the forms, was not medical director of the nursing home. That title was made up pursuant to an agreement between the physician and nursing home operator in an attempt to circumvent program requirements. The court found that the physician did not have the requisite knowledge and guilty intent to make false claims against the government.[18]

2. Intent

In some jurisdictions a showing of knowledge is not sufficient. The courts also read the statutes as requiring proof that the subject intended to defraud the United States in the submission of the claim.[19] As in a common law fraud claim, this necessitates that the false statement be material, that the subject know that it is false, and that the subject intend that the government rely on the statement, to its detriment.[20] One may also infer intent from the circumstances, based on the legal principle that an individual is presumed to know and intend the natural consequences of his acts.

The FCA also imposes liability for conspiracy to defraud. Under the conspiracy clause of FCA, the subject must also know that the claim is to be made on the government. By its terms, the statute's conspiracy language requires proof of the element of intent to defraud the government. Where "knowledge" is in issue, it is the nature of the statement and not the existence of civil liability that a subject must be shown to "know." The issues of knowledge and intent are vital ones and should be addressed early in the investigation.

Civil Monetary Penalties Law (CMPL)

The burden of proof on the government under the CMPL is substantially less in certain key areas. As the cases indicate, the concepts of knowledge and intent are not necessarily the same.[21] The pertinent language in the FCA is "... knowing such claim to be false, fictitious or fraudulent..." In the CMPL the analogous language, "... that the person knows or has reason to know...", suggests that the drafters of the CMPL were aware of the divergence of opinion as to the degree of knowledge required under the FCA and sought to avoid a similar problem. "Has reason to know" is a term of art under civil law which is analogous to the reasonable man standard, i.e., that a reasonable man would have known that his claim was for a medical or other item or service not provided as claimed, or otherwise ineligible for payment. The specific intent to deceive is clearly not a requirement of the CMPL nor is it absolutely necessary to prove actual knowledge of the falsity of the information provided. However, a showing of actual knowledge and/or intent is preferable since it will have greater "jury appeal" before the Administrative Law Judge (ALJ).

In comparing the FCA with the CMPL and the criminal False Claims statute:

1. An intent to defraud the government is a required

element under the FCA, 31 USC 231, in some circuits but not in others.[22]

2. An intent to defraud is not an element which is required under the criminal False Claims statute, 18 USC 287.[23]

3. 18 USC 287 uses the terms "false, fictitious, or fraudulent" in the disjunctive as does the FCA. Three different kinds of claims are, therefore, prohibited by the statutes. "A claim need not be fraudulent so long as it is false or fictitious.[24]

4. "A statement is 'false' or 'fictitious' if untrue when made, and is then known to be untrue by the person making it or causing it to be made. A statement or representation is 'fraudulent' if known to be untrue, and made or caused to be made with the intent to deceive the government agency to whom submitted."[25] Under this definition, the intent to deceive becomes relevant only when the government attempts to prove that the statement was fraudulent. When an indictment alleges only 'false' statements, the government should need to prove only that the statement was known to be untrue at the time it was made. Only if the government pleads and tries to prove that the claims were 'fraudulent' is there a requirement that a jury be instructed on intent to deceive, or presumedly that evidence need to be presented on this point.[26]

F. Damages

Whether or not the United States can prove actual damages, both the FCA and CMPL provide for the assessment of a fine or forfeiture each time the law is violated. For this reason, even where no damage occurred, as when improper claims are detected before payment, a case may be worth pursuing when a sufficient number of possible counts exist. However, where the number of claims is small but the dollar amount of each claim is large, it is the additional assessment which can provide the most substantial return to the government under the CMPL, since no fixed amount of damages need be proved.

In addition to the $2,000 forfeiture per claim, the FCA provides for the award of double the actual damages. There is no single rule as how damages are to be measured but the courts generally approve of common sense approaches. For example, if the government pays $500 for an item worth $300, the damages are $200; or if the government guarantees a loan it is later called upon to pay and actually pays off the loan, the government's damage is the amount paid the lender. The general rule is that the government's damage is the amount it would not have paid but for the violation. Suffice it to say that an investigation should include values, sometimes by audit or appraisal, of all relevant costs to the government.

Sometimes an assessment of damages is not possible without making estimates or averaging the results of samples over a large number of acts. This may be permitted by the court, particularly, where the subject's fraud enabled him to cover up the actual damage.

In cases involving fluctuating market values, care must be taken to document the market values at the time the particular transaction occurred. In other cases, it may be necessary to employ an independent appraiser or expert to compute damage or establish the fair value of the goods or services the government received.

The investigation should establish, by strong testimonial or documentary evidence, the existence of a pattern or standard method of executing the fraud. If a standard percentage for the kickbacks or the continuing use of a particular supplier can be established, or if the particular bookkeeping account or commodity used to accomplish the scheme can be identified, the additional proof necessary may be reduced to establishing the dates when the scheme began and ended.

FCA and CMPL have significantly different language as to forfeitures and assessments imposed. In addition to double damages, the FCA provides for a civil forfeiture of the fixed amount of "$2,000 [for each claim]." The CMPL provides for, "in addition to any other penalties that may be prescribed by law," a civil money penalty of "not more than $2,000 for eacn item or service," as well as an assessment of not more than twice the amount claimed for each item or service in lieu of damages. The "not more than" language indicates that the amount of penalty and assessment can be adjusted based on the circumstances in each case. Additionally, the language "for each item or service" differs from the "for each claim" language in the FCA. The precise meaning of CMPL's language is still to be determined, but it appears to increase the number of possible penalties and assessments in a given case, since a single claim may actually contain billings for a number of items or services.

Under both FCA and CMPL proof of damage to the government is not necessary to establish liability for the fine or forfeiture[27] and reliance by the government need not be proven to constitute a violation.[28] Under the FCA, damages are relevant only as to the amount of assessment to be sought in addition to the fine or forfeiture.

CMPL language, as to the assessment, appears to avoid the necessity of proving damages by providing for an assessment of not more than "twice the amount claimed for each item or service," in lieu of damages. Thus, although the government must prove that it has suffered damages, it need not establish the amount in order to be entitled to recover an assessment. In context, proof of damages on each count will be helpful, but it is evidently not a factor that must be proved before the government may assess a particular dollar amount. This assessment depends on the total amount claimed rather than the damages suffered. All questions as to number of individual violations, damages, forfeitures and assessment should be analyzed and resolved during the investigation and before any lawsuit has begun.

G. Financial Condition of Subject: Collectibility

From a practical standpoint, there is little to be gained by pursuing a penniless defendant. The investigator should identify and evaluate the subject's assets and general financial condition, in order to determine whether a CMPL case is worth pursuing. If possible, and not overly time-consuming, documentation such as copies of real estate and other public records, bank and savings records, etc., should be obtained. Particular attention,should be given to highly liquid, easily transferable or concealable assets. Where such assets exist, the government's civil attorneys should be notified immediately, since it may be possible to attach them or enjoin their transfer until the civil case is completed. Privacy Act provisions must be taken into consideration.

H. Statute of Limitations: False Claims Act (FCA) and Civil Monetary Penalties Law (CMPL)

The Statute of Limitations under the FCA is six years from the presentation of the claim. It is important to note that this is an absolute and strict limit. It is neither tolled by concealment, nor during the period of time when the government did not know of the fraud. The time does not run from the preparation of false documents but from the submission of the claim, which may be sometime later.[29] For these reasons, an evaluation of a potential civil investigation under the FCA should begin by identifying the claims and the dates on which they were submitted. Where the running of the statute appears imminent or likely to occur before the investigation is completed, direct contact with the Civil Fraud Division's attorney should be made promptly.

Defendants often argue that the Statute begins to run on the date of the "commission of the act," i.e., preparation of the claim. The government, on the other hand, asserts that the Statute does not begin to run until an actual "claim against the government" is submitted. The courts have supported the government theory. For instance, the Court of Appeals for the Third Circuit has stated that: "the conception of a claim against the government normally connotes a demand for money or for some transfer of public property."[30] For example, the Supreme Court held that a lending institution's application for credit insurance on a home loan is not a claim against the government within the meaning of the FCA.[31] In another case, the Supreme Court emphasized the requirement of immediate financial detriment in finding that the supplying of false information in support of an application to the Commodity Credit Corporation for a loan was a claim within the meaning of the FCA.[32]

In short, no cause of action arises and, therefore, the Statute of Limitations does not begin to run until a party presents a claim "with the purpose and effect of inducing the government immediately to part with money."[33]

As to the CMPL, there is no specific language in the CMPL about the Statute of Limitations. In theory, therefore, there may be no legal time restrictions on the filing of a CMPL action. In practice one would generally want to conform to the FCA, i.e., six years from date of commission.

III. COMPARISON OF THE STATUTORY PROVISIONS OF THE CIVIL MONETARY PENALTIES LAW, THE CIVIL FALSE CLAIMS ACT AND THE CRIMINAL FALSE CLAIMS STATUTE

Presented in this section is a comparison of the statutory provisions of the CMPL, codified as 42 USC 1320a - 7a, the Civil FCA, 31 USC 231, and the Criminal FCA, 18 USC 287. For purposes of simplification, the comments relative to the Criminal False Claims Statute appear in brackets.

1128A (CMPL), Social Security Act, [42 USC 1320a - 7a]	FCA, 31 USC 231 [Criminal False Statute, 18 USC 287][34]
1. Any person (including an organization, agency or other entity that...	1. Any person who... [Whoever]
2. presents or causes to be presented	2. shall make or cause to be made or present or cause to be presented, for payment or approval, [makes or presents]
3. to an officer, employee or agent of the United States, or of any department or agency thereof, or any State agency (as defined in subsection (h)(i), (i.e., receiving) funding under the Medicaid or Maternal and Child Health and Crippled Children's Services programs	3. to or by any person officer in the civil, military, or naval services of the United States, [to any person or officer in the civil, military or naval services of the United States, or to any department or agency thereof]

4. a claim (as defined in subsection (h)(2), i.e., an application, submitted by a Medicaid or Medicare provider or a provider of services under Title V, for payment of services	4. any claim[35] upon or against the government of the United States or any department or officer thereof [any claim upon or against the United States or any department or agency thereof]
5. That the Secretary determines-- (1) is for a medical or other item or service-- (A) That the person knows or has reason to know was not provided as claimed, or (B) payment for which may not be made, pursuant to a determination by the Secretary under section 1128, 1160(b) 1862(d) or 1855(b)(2), or (2) is submitted in violation of an agreement between the person and the United States or a State agency	5. knowing such claim to be false, fictitious or fraudulent, or who, for the purpose of obtaining or aiding to obtain the payment or approval of such claims, makes, uses, or causes to be made or used, any false bill, receipt, voucher, roll, account, claim certificate, affidavit, or deposition, knowing the same to contain any fraudulent or fictitious statement or entry, or,... who enters into any agreement, combination, or conspiracy to defraud the government... by obtaining or aiding to obtain the payment of any false or fraudulent claim...

	[knowing such claim to be false, fictitious, or fraudulent,][36]
6. shall be subject, in addition to any other penalties that may be prescribed by law to a civil money penalty of	6. shall forfeit and pay to the United States [is guilty of an offense against the United States,]
(a) not more than $2,000 for each item or service, and	(a) the sum of $2,000, and
(b) in addition, such a person shall be subject to an assessment of not more than twice the amount claimed for each such item or service in lieu of damages sustained by the United States or State agency because of such claim.	(b) in addition, double the amount of damages which the United States may have sustained by reason of the doing or committing such act,
	(c) together with the cost of suit.

Whereas the FCA applies government-wide, CMPL claims are restricted to those under the Medicaid, Medicare and Maternal and Child health and Crippled Children's Services programs. However, the statutory definition of a claim contained in the CMPL is well within the accepted wider meaning applicable under the FCA. Under the FCA, civil lawsuits are brought by the Civil Division of the Department of Justice (DOJ).

It is important that the statutory requirements and elements of proof under the civil and criminal statutes not be confused.

IV. CRIMINAL AND CIVIL FRAUD PROSECUTION

A. Use of Prior Criminal Litigation and Conviction: Estoppel

While it is not legally required, the Federal government's normal procedure is to pursue criminal prosecution first. Also, when there is an opportunity to prosecute under either 18 USC 287 or 18 USC 1001 (false statements), it is generally preferable for the government to prosecute under 287 because this will allow the government to take advantage of the doctrines of estoppel by judgment and res judicata. 18 USC 1001 is acceptable if the "false statements" are also "claims" within the meaning of the FCA or CMPL.

Estoppel by judgment means that when a fact has been decided in a court proceeding, neither of the parties shall be allowed to call it into question or have it tried over again in a subsequent proceeding.

Res judicata is a related, more general, concept that a final judgment rendered by a competent court on the merits is conclusive as to the rights of the parties and, as to the parties involved, constitutes an absolute bar to any subsequent action by either party involving the same claim, demand or cause of action.

In Berdick v. United States, a doctor was convicted of 42 counts of submitting false "Requests for Medicare Payments," in violation of 18 USC 1001. The government then claimed that in the course of filing the Medicare claims that led to his conviction, he also violated the FCA 31 USC 231. The court found "that the facts developed at Berdick's trial, which are the basis of his criminal conviction under 18 USC 1001, are indeed sufficient to prove also his violation of the FCA and his liability to the government thereunder." The court ruled that the doctor was estopped from relitigating the facts which imposes a penalty on any person who presents for payment any claim upon or against the government knowing such claim to be false. Since 18 USC 1001 and 31 USC 231 both deal with similar activity, a criminal conviction under the former statute could be used to establish civil liability for violations of the latter statute.[37]

In United States v. Jacobson, the defendant convicted by a jury on 18 counts of violating 18 USC 287 by submitting false Medicaid claims to the Department of Health and Human Services (DHHS), and 18 counts of violating 18 USC 1001 by making false statements on matters within the jurisdiction of DHHS. The same 18 invoices which formed the basis for the criminal charges were then used as the basis for the filing of a civil action under 31 USC 231. The judgment of criminal conviction under 18 USC 287 was filed with the civil court. The court found that because all questions relevant to civil liability were distinctly put into issue and directly determined in criminal prosecution, the grant of summary judgment was warranted. The court also acknowledged Federal jurisdiction in part based on DHHS reimbursement of the state for Medicaid claims at the rate of fifty cents on the dollar.[38]

If a civil action is based on the same claim, transaction or operative facts of a prior criminal adjudication, then the defendant who has been found guilty or pleaded guilty is prevented from denying or relitigating the same charges in the civil case (collateral estoppel).[39] Acceptance of a plea of nolo contendre should be avoided, since it forfeits any benefit to be derived civilly or administratively from prior criminal litigation.[40]

A civil case that parallels a criminal case, therefore, is greatly enhanced by a prior criminal conviction, but the elements of violation must be substantially similar. A verdict against a party in a mail fraud or tax evasion count will generally not prohibit a defendant from denying that he submitted false claims, since the elements of proof are different. It is generally accepted that the doctrine of collateral estoppel does apply to FCA suits.[41] An acquittal in the criminal case, however, does not estop the United States from bringing the civil case because of the lower burden of proof in civil cases. The law does indicate that pleas of guilty to a conspiracy count alone forfeits any benefit to be derived from prior criminal litigation,[42] except as to a single count of conspiracy under the FCA. Pleas to substantive false claims counts should be taken.

Two critical differences in prosecutorial theories between criminal and civil cases must be kept in mind. First, the criminal case need not prove damages to prove a violation. Although a good criminal presentation often includes such proof, prosecuting attorneys may not require an in-depth analysis. However, in the civil investigation, such analysis is a must, and the time to do it is early in the investigation. Second, while the criminal investigation may involve the subject's submission of a large number of false claims over a multi-year period, practical requirements of proving each count may force the prosecutor to focus on only the "best" false claims. The civil investigation, on the other hand, because of the lower burden of proof, may be able to include most or all of the false claims.

There may be problems inherent in the use of Federal Grand Jury (6e) material or other information derived from criminal discovery.[43] Consult the Civil Division attorney promptly when Grand Jury material is involved. This issue is now before the United States Supreme Court.

Generally, all of the information developed during the criminal investigation will be relevant to the civil fraud investigation. As a matter of good practice, all evidence, work papers, etc., should be preserved for use in the civil investigation.

B. Guilty Pleas and Related Counts

In a recent case the court found that defendants who had pleaded guilty were collaterally estopped from relitigating issues essential to the convictions and, as a result, were liable under the FCA for the claims which were the basis of the eight counts under 18 USC 1001 and the one conspiracy count. The court found, however, that the government was not entitled to summary judgment for those allegedly false statements that were not established by the defendants' guilty pleas, except where otherwise proven. It thus appears that the conviction estopped the defendant only from relitigating those counts directly charged and on which he was found or pleaded guilty. As to the remainder of the 1,522 allegedly false claims, they would have to be independently proven to violate the FCA.[44]

A defendant who pleaded guilty may later argue that he did not realize that the plea would estop him from relitigating the issue in a subsequent civil proceeding. In one case, the court held that defendants cannot expect the court to look behind their convictions, especially when the record demonstrated that the pleas were made knowingly and voluntarily.[45] To prevent such problems, prosecutors taking pleas should be encouraged to take as complete a plea as possible, with emphasis on acknowledgement of their acts and an understanding that the pleas can be used against them in subsequent civil proceedings.

C. Venue

When a crime is composed of distinct parts or began in one district and completed in another, venue may be proper in more than one district.

The relevant language in the CMPL reads: "presents or causes to be presented..." The language in the CMPL does not include the term "making," which is present in the FCA. In view of the case history, venue should be proper in a CMPL case:

1. Where the claim is put into the mail or otherwise submitted;
2. Where the claim is received by the intermediary; or
3. Where a request for reimbursement is received by a government agency after transmittal by the intermediary which processed and paid the claim.

Note, also, under the FCA that venue may also be proper in the jurisdiction where the claim was "made."[46]

D. Double Jeopardy

The imposition of civil sanctions under the FCA on a defendant convicted of criminal violation of 18 USC 287 does not place the defendant in double jeopardy and does not constitute cruel or unusual punishment. It is well accepted that the double jeopardy provisions of the Fifth Amendment are criminal in nature and do not apply to civil contexts. For one act, therefore, a person may be liable both for damages and for a criminal penalty.[47]

E. Burden of Proof

1. Under the civil FCA and based on what is known about Congressional intent, case law and statutory language, it has been determined that the government must establish,

by "clear and convincing evidence" the following elements:

  a. The defendant presented or caused to be presented for payment or approval, to the government of the United States a claim upon or against the United States;
  b. The claim was false, fictitious or fraudulent;
  c. The defendant knew that the claim was false, fictitious or fraudulent; and
  d. To recover damages, it must be shown that the United States sustained damages because of the false claim.[48]

2. Under the criminal False Claims Statute, 18 USC 287, as in other criminal cases, the government must prove all the elements of a crime "beyond a reasonable doubt."
3. Under the CMPL there is, as yet, no statutory or judicial definition of the burden of proof. However, draft regulations provide that: "The issues to be decided at the hearing are:
   a. Based upon clear and convincing evidence, whether the respondent submitted a claim...and, if so,
   b. Based upon a preponderance of the evidence, the amount of the penalty to be imposed." (42 CFR 420.411(a))

V. CASES SUITABLE FOR CIVIL MONETARY PENALTY RECOVERY

Implementation of the CMPL by DHHS is subject to the Memorandum of Understanding (MOU) between DHHS and the DOJ. DHHS may not commence an administrative proceeding in any case until the Inspector General has complied with the procedures specified in the MOU.

Keeping these requirements in mind, there are six broad categories of fraud and abuse cases that are suitable for civil monetary penalty action:

1. Cases where an investigation has been conducted but closed prior to the case being referred to the DOJ for consideration of criminal prosecution. Examples include: cases with a small overpayment not great enough to warrant criminal prosecution; or the absence of sufficient criminal intent to sustain a criminal conviction.
2. Cases that have been investigated and referred to the DOJ for criminal prosecution but declined due to the workload of the United States Attorney; the small number of potential counts; or the amount of overpayment is not great enough to warrant criminal prosecution.
3. Cases that have been accepted by the DOJ for criminal prosecution but where no conviction was obtained, or where the subject was convicted on only a portion of the counts originally brought.

4. Cases where the subject is convicted of a criminal offense but the DOJ decides not to take civil action.
5. Cases where the subject is convicted in State court of a Medicaid or Title V related offense, and the DOJ will not take civil action.
6. Cases where a state investigation of a Medicaid or Title V case does not result in a state prosecution, but where the merits of the case indicate Federal civil fraud potential, and the DOJ will not take civil action.

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2. What Is A "Claim" Against The United States Within The Meaning of the False Claims Act? Annotation, 19 L. Ed_2 1558; also see 2 L. Ed_2 2054.

3. Criminal Prosecution Or Disciplinary Action Against a Medical Practitioner For Fraud In Connection With Claims Under Medicaid, Medicare Or Similar Welfare Programs For Providing Medical Services. 50 ALR 3d 549.

4. Note, False Claims Act--The Civil War Antitrust Sword: United States v. Beatrice Foods Company. 25 Southwest LJ 764.

5. Comment, Qui Tam Suits Under The Federal False Claims Act: Tool Of The Private Litigant In Public Actions, 67 Northwestern UL Rev. 446.

6. Measure and Elements of Damages Under False Claims Act, 35 ALR Fed. 805.

7. Presentation Of, And Attempt To Establish, Fraudulent Claims Against Governmental Agencies, 21 ALR 1.

8. Conviction Or Acquittal In Criminal Prosecution As Bar To Civil Action For Statutory Damages Or Penalty, 100 L. Ed_2 156 (1955).

952-53, 2 L. Ed_2 1001 (1958), quoted in United States v. Bornstein, 423 US 303, note 4, 96 S. Ct. 520, note 4: or, more generally, "actions which have the purpose and effect of causing the government to pay out money are clearly 'claims' within the meaning of the Act." United States v. Silver, 384 F. Supp. 617, 620 (E.D., N.Y., 1974); affirmed 515 2d 505 (CA 2, 1975). Examples include: submitting a loan application to a Federal agency. United States v. Neifert-White, supra; depositing a Treasury check through normal banking channels. United States v. Silver, supra; and submitting invoices to the government for payment for a manufactured product. United States v. Bornstein, supra.

7. Even the cashing of a check may be a "claim" United States v. Branker, 395 F. 2d 881 (CA_2 1968); cert. denied sub. nom. Lacy v. United States 393 US 1029 (1969); Scolnick v. United States, 331 F. 2d 598 (CA 1, 1964).

8. Rainwater v. United States, 356 US 590, 592, 2 L. Ed_2 996, 998, 78 S. Ct. 946 (1958); see also United States v. Neifert-White, supra at 233.

It has been noted that "fraud" implies a misrepresentation of a material fact, either expressed or implied. United States v. Lawson, supra 522 F. Supp. at 749 (D.C. N.J., 1981). United States v. Klein, 230 F. Supp. 426, 432 (W.D. Pa. 1964); United States v. Silver, supra, 384 F. Supp. at 620. United States v. Farina, 153 F. Supp. 819, 822 (D.C. N.J., 1957).

CITATIONS

1. "Any person who shall make or cause to be made or present or cause to be presented, for payment or approval to or by any person or officer in the civil, military or naval services of the United States, any claim upon or against the Government of the United States, or to any department or agency thereof, knowing such claim to be false, fictitious or fraudulent, or who, for the purpose of obtaining or aiding to obtain the payment or approval of such claims, makes, uses, or causes to be made or used, any false bill, receipt, voucher, roll, account, claim, certificate, affidavit, or deposition, knowing the same to contain any fraudulent or fictitious statement or entry, or... who enters into any agreement, combination, or conspiracy to defraud the government... by obtaining or aiding to obtain the payment of any false or fraudulent claim... shall forfeit and pay to the United States the sum of $2,000 and, in addition, double the amount of damages which the United States may have sustained by reason of the doing or committing of such act.

2. United States v. Ridglea, 357 F. 2d 495, 498 (CA 5, 1966) citing Restatement (Second) Agency §235 (1958).

3. United States v. Ridglea, supra, 357 F. 2d at 499.

4. United States v. Ridglea, supra, at 498-499. See also Gleason v. Seaboard Airline R'Y, 278 U.S. 349, 73 L. Ed. 415, 49 S. Ct. 161

(1929); Rutherford v. Rideout Bank, 11 Cal. 2d 479, 80 p. 2 978, 117 ALR 383 (1938); Restatement (Second) Agency §257 and comment; Mechem Outlines of the Law of Agency §§131-135 (4th ed. 1952).

5. Ibid. The court found imposition of such liability unfair in a case involving the "mandatory" $2,000 forfeiture and double damages, unless the agent is acting with an intent to benefit his employer. The court stated that where only a single officer of a bank had actual knowledge of the falsity of documents which accompanied a claim for reimbursement and the officer was not acting with the purpose of benefiting the bank but to profit personally, the guilty intent of the officer would not be imputed to the bank and the bank would not be liable for forfeitures and double damages under FCA. See also Standard Oil Co. of Texas v. United States, 307 F. 2d 120 (CA 5, 1962).

6. United States v. Neifert-White Co., 390 U.S. 228, 233, 19 L. Ed_2 1061, 1065, 88 S. Ct. 959; See Rainwater v. United States, 356 US 590, 592, 2 L. Ed_2 996, 998, 78 S. Ct. 946 (1958) and annotation, "What Is A 'Claim' Against the United States Within Meaning of Federal False Claims Act." 19 L. Ed_2 1558. Also see United States v. Lawson, 552 F. Supp. 746, 749 (D.C., N.J. 1981); United States v. Hibbs, 586 F. 2d 347, 350 (CA 3, 1978). Presentation of a claim against the government "normally connotes a demand for money or for some transfer of public property" United states v. McNinch, 356 US 595, 78 S. Ct. 950,

The False Claims Act has been used to cover a variety of situations: against a physician convicted of Medicare fraud. United States v. Zulli, 418 F. Supp. 252 (E.D. Pa., 1970); against a government contractor for billing for non-existent or worthless services. United States ex rel Weinberger v. Equifax, Inc., 557 f. 2d 456 (CA 5, 1977), cert. den 434 US 1035, 98, S. Ct. 768, 54 L. Ed_2 782 (1978); against a veteran for hospitalization benefits received for nonservice-connected disability. United States v. Shanks, 384 F. 2d 721 (CA 10, 1967); and to recover against a contractor for briding a Federal agent. United States v. Cripps, 460 F. Supp. 96 (E.D. Mich., 1978).

9. United States v. Neifert-White Co., supra.

10. United States v. Lawson, 522 F. Supp. 746, 749 (D.C. N.J., 1981); United States v. Marple Community Record, Inc., 335 F. Supp. 95 (E.D. Pa. 1971); United States v. Howell, 318 F. 2d 161, 166 (CA 9, 1963).

It appears that a cost report must be considered a single claim even though it consists of a number of different line items. See Miller v. United States, supra, 550 F. 2d et 24. The rationale is that a single overall amount is requested regardless of the number of false items of information provided. See also United States v. Bornstein, supra; and United States v. Woodbury, 359 F. 2d 370 (CA 9, 1966).

11. See United States ex rel Davis v. Long's Drugs, Inc., 411 F. Supp. 1144, (S.D. Cal. 1976).

12. United States v. Jacobson, 467 F. Supp. 507 (S.D. N.Y., 1979); United States ex rel Davis v. Long's Drugs, Inc., supra. at 1146. United States ex rel Marcus v. Hess, 317 US 537, 63 S. Ct. 379, 87 L. Ed 443 (1943); United States v. Brogren, 63 F. Supp. 702 (D. Mass 1945).

13. United States ex rel Davis, supra, at 1149 citing Peterson v. Weinberg, 508 F. 2d 45 (CA 5, 1975) and United States v. Catena, 500 F. 2 1319 (CA 3, 1974).

14. United States ex rel Davis, supra at 1149, citing United States v. Neifert-White, supra and United States ex rel Marcus v. Hess, supra.

The conclusions are clearly based on the extensive Federal regulations, reporting requirements and other contracts. but see United States v. Azzarelli Construction Co., 647 F. 2 757, 761 (CA 7, 1981). Contrary results under Federal Aid Highway Act.

15. United States v. Cooperative Grain & Supply Co., 476 F. 2d 47, 56 (CA 8, 1973), cases cited United States v. Hughes 585 F. 2d 284 (CA 7, 1978).

16. Miller v. United States, 550 F. 2d 17 (CT Cl., 1977), United v. Ekelman & Associates, 532 F. 2d 545, 35 ALR Fed. 794 (CA 6, 1976) and annotation: Measure and Elements of Damages Under FCA, 35 ALR Fed 805; U.S. v. Ueber, 299 F. 2d 310, 314 (CA 6, 1962).

17. United States v. Cooperative Grain, supra, at 298 and annotation, 26 ALR Fed. 307, on Specific Intent. See Cooper v. Schlesinger, 111 US 148, 155, 28 L. ed 382, 4 S. Ct. 360 (1883) and Prosser, Torts, 715-716 (2d Ed. 1964); and see Miller v. United States, supra, 550 F. 2d at 23, where the court held that extreme negligence on the part of a person who submits a false bill to the government is within the scope of prescribed conduct under 31 USC 231.

18. Peterson v. Weinberg, 508 F. 2d 45, (CA 5, 1975) cert. den. 423 US 830, 46 L. Ed_2 47, 96 S. Ct. 50.

19. United States v. Mead, 426 F. 2d 118 (CA 9, 1970), but cf United States v. Ekelman & Assoc., supra, which finds to the contrary.

20. United States v. Ueber, supra, 299 F. 2d at 314. See United States ex rel Hughes v. Cook, 499 F. Supp. 784, 786-87 for discussion of "scienter" and analysis of cases on both sides of the question.

As to materiality, the False Claims Act has been carefully restricted to cases of intentional, deliberate fraud and has no application to unintentional technicalities. The court, in United States ex rel Highes v. Cook, supra, 499 F. Supp. at 788 refused to apply it to a case involving "some technicalities with any defendant physician's license." Also, see Weinstein v. Bressler, 160 F. 2d 403 (CA 2, 1947), where the court rules that Sherman Act violations did not constitute fraudulent misrepresentations under the Act.

21. See *United States v. Cooperative Grain*, supra, and annotation, 26 ALR Fed. 307.

22. *United States v. Mead*, supra, and *United States v. National Wholesales*, 236 F. 2d 944 (CA 9, 1956), *cert. den*. 353 US 930, 77 S. Ct. 719, 1 L. Ed$_2$ 724.

Leaving a blank is equivalent to an answer of "none" or a statement that there are no facts required to be reported. "If there are facts that should have been reported, leaving a blank belies the certification on the front page of the application that the information therein is 'true and correct'", *United States v. Irwin*, 654 F. 2d 671, 676 (CA 10, 1981). Irwin left blank a space entitled "compensation already paid." See also *United States v. McCarthy*, 442 F. 2d 160, 162 (CA 2, 1970), cert. dismissed, 398 US 946, 90 S. Ct. 1864, 26 L. Ed$_2$ 286.

In addition, the falsification was held to be material in that it had a "natural tendency to influence, or was capable of influencing the decision of the Tribunal required to be made." *Irwin*, supra, at 286 F$_2$ 2118, 120-121 (CA 10, 1961), *cert. den*., 365 US 878, 81 S. Ct. 1028, 6 L. Ed$_2$ 190. Gonzalez involved 18 USC 1001. It has been held that there is not a materiality requirement in 18 USC 287, the Criminal

False Claims Statute. Irwin distinguished Gonzalez in finding "no indication in either the statutory language of §287 or its legislative history that Congress intended materiality to be an essential element of §287." 677 F. 2d at 682, distinguishing cases to the contrary. Based on similarities in statutory language, it appears that materiality will not be a requisite factor in CMPL cases.

23. United States v. Milton, 602 F. 2d 231, 233 (CA 9, 1979).

24. United States v. Irwin, supra, 654 F. 2d at 683; United States v. Milton, supra, at 233; United States v. Mead, 582 F. 2d 842, 847 (CA 4, 1978).

25. Ibid, citing 2 E. Devitt and C. Blackman, Federal Jury Practice and Instructions, 3rd Ed. 1977, §28.04.

26. Ibid.

27. Fleming v. United States, 336 F. 2d 475, 480 (CA 10, 1964) cert. den., 380 US 907, 855 S. Ct. 889, 13 L. Ed_2 795 (1965); United States v. Tieger, 234 F. 2d 589, 590 and n.4 (CA 3 1955), cert. den., 352 US 941, 755 S. Ct. 262, 1 L. Ed_2 237 (1956). See also United States v. Hughes, 585 F. 2d 284, 286, (CA 7, 1978); United States v. Rohleder, 157 F. 2d 126, 129 (CA 3, 1946).

28. United States v. Dinerstein, 362 F. 2d 852, 856, (CA 2, 1966).

29. United States v. Ueber, supra, 299 F. 2d at 313; United States v. Globe Remolding Co., 196 F. Supp. 652, 655 (D. UT, 1960).

30. United States v. McNinch, 356 US 595, 785 S. Ct. 950, 2 L. Ed_2 1001, 1004, (1958); United States v. Tieger, 234 F_2 589, 591. Also see United States v. Ekelman, supra, 532 F. 2d at 552.

31. United States v. McNinch, supra.

32. United States v. Neifert-White,supra, 390 US at 232, 88 S. Ct. at 961, 19 L. Ed_2 at 1065.

33. United States v. Ekelman, supra, 532 F. 2d at 553.

34. United States v. Johnson, 284 F. Supp. 273 (D. Mo., 1968); affirmed 410 F_2 38 (CA 8, 1969).

35. United States v. Coggin, 3 F. 492 (CA 7, 1880).

Essential Elements of Violating 18 USC 287:

a. That the defendant knowingly and willfully made or presented a claim to a government agency or aided and abetted, or caused another person to make such claim;

b. That such claim was made or presented upon or against a department or agency of the United States;

c. That such claim was false, fictitious and fraudulent; and

d. That the defendant knew that such claim was false, fictitious or fraudulent.

36. See *United States v. Milton*, supra.

37. *Berdick v. United States*, 612 F. 2d 533 (U.S. Ct. Cl. 1979); *Brown v. United States*, 524 F$_2$ 693, 705, 207 Ct. Cl. 768, 778 (1975). See *Emich Motors Corp. v. General Motors Corp*., 340 US 558, 568, 71 S. Ct. 408, 95 L. Ed 534 (1951); see also *Sealfon v. United States*, 332 US 575 (1958); Department of Justice, Civil Division Fraud Section, Practice Manual, 611-616 (1969); *United States v. Rapport*, 514 Supp. 519, 522 (S.D. N.Y., 1981) *United States v. Podell*, 572 F. 2d, 31, 35 (CA 2, 1978); *United States v. Frank*,494 F$_2$ 146, 160 (CA 2), *cert. den*., sub nom.

38. *Borgman v. United States*, 419 US 828, 95 S. Ct. 48, 42 L. Ed$_2$ 52 (1974), 467 F. Supp. 507 (S.D. N.Y., 1979).

39. *United States v. Jacobson*, 467 F. Supp. 507 (S.D. N.Y., 1979) *Frank v. Morgan*, 237 US 309, 334, 35 S. Ct. 582, 590, 59 L. Ed. 969 (1915); *United States v. Cripps*, 460 F. Supp. 969, 975 (E.D. Mich., S.D., 1978); *Local Brotherhood of Teamsters v. United States*, 291 US 293, 54 S. Ct. 396, 78 L. Ed. 804 (1934); *Blumen v. Haff*, 78 F. 2d 833 (CA 9, 1935); *United States v. Eagle Beef Cloth Co*., 235 F. Supp. 491, 492

(E.D., N.Y., 1964); *United States v. Levinson*, 369 F. Supp. 575, 579 (E.D., Mich., 1973).

40. *Hudson v. United States*, 272 US 451, 455 (1962).

41. *United States v. Katz*, 419 F. Supp. 846, 850-51 (E.D., Pa., 1976); *United States v. Zulli*. 48 F. Supp. 252 (E.D., Pa., 1975); *United States v. Greensberg*, 237 F. Supp. 439 (S.D., N.Y., 1965).

42. *United States v. Ben Grunstein & Sons, Inc*., 127 F. Supp. 907, 910 (D. N.J., 1955).

43. *United States v. Proctor & Gamble Co*., 356 US 677 (1958).

44. *Alsco-Harvard Fraud Litigation*, 523 F. Supp. 790, 802-804 (D.C., D.C., 1981). See also *Emich Motors*, supra, 340 US at 569, 71 S. Ct. at 414, 95 L. Ed 534.

45 *Alsco-Harvard Fraud Litigation*, supra, 523 F. Supp., 801.. *See also Plunkett v. Commissioner*, 465 F. 2d 299 (CA 7, 1972) and *Brady v. United States*, 397 US 742, 757, 90 S. Ct. 1463, 1473, 25 L. Ed$_2$ 747 (1970).

46. See *United States v. Bleckner*, 657 F_2 629 (CA 4, 1981); *United States v. Herberman*, 583 F. 2d 222, 227 (CA 5, 1978), [where made] or *United States v. Valenti*, 207 F_2 242, 245 (CA 3, 1953) [where presented to government].

47. *United States v. Berdick*, supra; *United States ex rel Marcus*,

supra; One Lot Emerald Cut Stones v. United States, 409 US 232, 237, 93 S. Ct. 489 34 L. Ed_2 438 (1972). See also Rex Trailer Co. v. United States, 350 US 148, 76 S. Ct. 219, 100 L. Ed 149 (1955), annotation, 100 L. Ed 156.

48. United States v. Lawson, supra, 522 F. Supp. at 749-750; United States v. Klein 230 F. Supp. 426, 431 (W.D. Pa., 1964), affirmed 356 F. 2d 983 (CA 3, 1966). See generally, United States v. Bornstein, supra; United States v. Neifert-White, supra; United States v. McNinch, supra, United States v. Hibbs, supra; United States v. Howell, 318 F. 2d 161 (CA 9, 1963); United States v. Veneziale, 268 F_2 504 (CA 3, 1959); United States v. Marple Community Record, Inc., 335 F. Supp. 95 (E.D., Pa., 1971); United States v. Mead, supra. Also see United States ex rel Brensilber v. Bausche & Lomb Optical Co., 131 F. 2d 545 (CA 2, 1942), affirmed by an equally divided court, 320 US 711, 64 S. Ct. 187, 188 L. Ed 417 (1943) (per curiam) which regarded the False Claims Act as a penal act and strictly construed its provisions, but see United States ex rel Marcus v. Hess, supra, 317, US 549-52, which characterized the False Claims Act as "remedial" and one which merely imposes civil sanctions.

Note, Hageny v. United States, 570 F. 2d 924, 933 (Ct. Cl., 1978), which traces the phrase "clear and convincing" back to 1908 and holding that "defendant's burden is such that the evidence of record must be so clear and convincing that the mind can rest with safety upon a finding that fraud has been established," quoting New York Market Gardener's Ass'n v. United States, 43 Ct. Cl., 114, 138.

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Fraud In Government Programs: --How Extensive Is It? --How Can It Be Controlled?

Volume I

Fraud against Government programs is widespread. It undermines the integrity of Federal programs and makes people lose confidence in public institutions.

Good systems of internal controls would prevent much of the fraud, or at least detect it sooner. However, controls over Federal programs are often inadequate, nonexistent, or ignored.

Most fraud is undetected. For those who are caught committing fraud, the chances of being prosecuted and eventually going to jail are slim. Further, agencies do not always use the administrative actions available to deter persons from committing fraud. The sad truth is that crime against the Government often does pay.

Agency inspectors general and the Department of Justice are making progress in the fight against fraud. However, more needs to be done to prevent fraud and to punish those who commit fraud.

UNITED STATES GENERAL ACCOUNTING OFFICE

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

FRAUD IN GOVERNMENT PROGRAMS:
--HOW EXTENSIVE IS IT?
--HOW CAN IT BE CONTROLLED?
Volume I

DIGEST

Fraud is willful wrongdoing by individuals or public and private organizations that affects the Government's interests. Despite the fact that so much has been written and discussed about fraud in Government programs, there is little concrete information as to its extent and characteristics. Without such data, it is hard to effectively detect and prevent wrongdoing. To rectify that situation, GAO made a statistical analysis of over 77,000 cases of fraud and other illegal activities reported in 21 Federal agencies during the 2-1/2 year period, October 1, 1976, through March 31, 1979.

FRAUD IS COSTLY

A statistical projection by GAO indicates that the loss to the Government on the 77,000 cases would total between $150 and $220 million. These losses are only what is attributable to known fraud and other illegal activities investigated by the Federal agencies in this study. It does not include, of course, the cost of undetected fraud which is probably much higher because weak internal controls allow fraud to flourish. Also, this estimate does not include cases involving Federal funds where State and local jurisdictions had primary investigatory responsibility. Some of those losses were substantial.

Losses due to fraud and related illegal activities are seldom recovered. Although agencies planned to recover between 20 and 29 percent of their losses either through court ordered restitutions or administrative actions, GAO believes that actual recoveries are probably much lower. GAO plans, in another study, to address how agencies can increase the recovery of fraud losses. (See pp. 4-5.)

The cost of fraud and illegal activities cannot always be measured in dollars and cents. Fraud erodes public confidence in the Government's ability to efficiently and effectively manage

Tear Sheet. Upon removal, the report cover date should be noted hereon.

its programs. In addition, fraud undermines program effectiveness. In some instances illegal activities have adversely affected public health and safety. (See p. 15.)

FRAUD IS WIDESPREAD

Many types of individuals and organizations commit fraud against the Government. Government employees committed about 29 percent of the frauds included in GAO's study. These employees represented four-tenths of one percent of the total Federal work force in the 21 Federal agencies reviewed by GAO. Other individuals and organizations committed about 40 percent. In the rest of the cases, suspects were never identified. Federal employees detected the majority of the reported frauds. (See pp. 6-7.)

Federal agencies were susceptible to hundreds of different types of fraudulent activities in a wide range of areas. However, four areas were especially prone to fraud:

--Financial assistance to individuals.
--Inventory control and property management.
--Mail service.
--Personal property management.

The types of illegal activities which occurred most often were false statements and theft. (See pp. 8-15.)

CONTROLS TO PREVENT FRAUD ARE OFTEN WEAK

Internal controls are checks and balances over all fiscal and managerial activities of an organization. The controls are designed to prevent the misuse or abuse of money or property. GAO found that weak internal controls often contributed to cases of fraud and other illegal activities. GAO analyzed the adequacy of internal controls for selected cases and found many instances where controls were either inadequate, not followed, or nonexistent. (See pp. 16-19.)

MANY CASES ARE NOT PROSECUTED

For a variety of reasons, the Justice Department declined to prosecute 61 percent of the over 12,900 cases referred by Federal agencies. Although Justice got a conviction or guilty plea in the majority of cases it did prosecute, the courts often suspended large portions of the sentences or granted probation. About one-third of those sentenced actually spent time in prison.

Fifty-seven percent of those who went to prison were sentenced to 6 months or less. At the other end of the spectrum, over a quarter of those who went to prison were sentenced to serve over 2 years. Information on how much time the individuals actually spent in prison before parole was not readily available. (See pp. 28-32.)

In addition to criminal prosecutions, the Department of Justice can take civil legal action against persons who defraud the Government. The primary civil fraud statute, the False Claims Act, allows the Federal Government to recover double damages from those who make false claims for such things as reimbursement under Government contracts or false statements in applying for benefit programs. It also allows the Government to recover one $2,000 forfeiture for each false claim made. Justice took civil action in 28 of the 393 fraud cases Federal agencies referred for such action during the period of GAO's review.

Following an October 1979 GAO report which concluded that Justice had not emphasized the civil aspects of fraud cases and needed to better coordinate criminal and civil actions, Justice put greater emphasis on coordinated criminal and civil prosecutions of Government fraud cases. (See pp. 32-34.)

AGENCIES DO NOT ALWAYS TAKE EFFECTIVE ADMINISTRATIVE ACTIONS

Agencies did not always take administrative action against individuals who committed fraud. When the agencies did act it was not always in a way that would deter others from defrauding the Government. For example, one of the major actions against individuals defrauding the Government was declaring them ineligible to participate in the programs they defrauded. This can be an effective deterrent in those cases where eligible program participants are seeking excessive benefits. However, the deterrent effect of this action is nil in those instances where the individuals never were eligible for the programs. (See pp. 34-38.)

PROGRESS IS BEING MADE IN COMBATING FRAUD

In 1978 GAO reported that Federal agencies were not aggressive in detecting fraud and had not fixed responsibility for identifying fraud in agency programs. GAO also reported that the Department of Justice had been slow to assist, coordinate, and monitor antifraud efforts of Federal agencies. Since then, progress has been made in these areas.

Congressional establishment of offices of inspectors general in 15 Federal agencies has provided an independent focal point for fraud detection and prevention. Among other things, inspectors general have worked together to address common problems, have undertaken joint audits and investigations, and have taken more active approaches in dealing with fraud and other illegal activities. (See pp. 40-43.)

The Department of Justice has also tried to upgrade Federal antifraud activities by (1) reorganizing certain Justice components to offer better services to agencies and allow Justice headquarters to work more efficiently with U.S. attorneys, (2) increasing specialized fraud training for Justice and agency personnel, and (3) working closely with the inspectors general through the Executive Group to Combat Fraud and Waste in the Government--an organization set up by the President in 1979 as a communication network for the inspectors general to share ideas and problems. (See pp. 43-45.)

CONCLUSIONS

Fraud and illegal acts against the Federal Government are a widespread problem. Once they are allowed to occur, the Government fights a losing battle because losses are seldom recovered and the perpetrators are seldom punished.

Weaknesses in internal controls often allow fraud to occur. Given the poor state of controls in many programs, it is probable that most fraud remains undetected.

GAO believes that the key to fighting fraud is to improve internal controls so that fraud and related illegal acts are more difficult to commit. Internal controls in Government are often ineffective and fraud and related illegal acts are easy to commit. Federal managers must ensure that controls are understood, encouraged, and enforced.

Each Federal agency is required by the Budget and Accounting Procedures Act of 1950 to maintain adequate systems of internal control. GAO believes that internal controls can be made more effective by strengthening existing law. The Congress is considering legislation which would require greater accountability by the heads of agencies for the effectiveness of their organizations' internal control systems. The Federal Managers' Accountability Act of 1981 (H.R. 1526) would, among other things, require agency heads to periodically evaluate controls and report the results to the Congress and the President. GAO believes this legislation would contribute to the development of adequate internal control systems in the Federal Government.

Auditors have an important role in assisting management by testing internal control systems and recommending needed improvements. Auditors can help prevent fraud by keeping surveillance over the effectiveness of internal controls.

GAO believes that the prevention of fraud and related acts through effective systems of internal control is top priority. It also recognizes the deterrent effects of punishing perpetrators. Because the number of cases makes it impossible for the Department of Justice to prosecute every case of fraud referred to it by Federal agencies, it is even more important that Federal agencies take effective administrative actions when warranted. In addition, GAO believes that civil fine authority could be a useful enforcement tool for agencies whose cases the Department of Justice declines to act on.

The Department of Justice is now completing draft legislation which would allow agencies to levy civil monetary penalties. This legislation would authorize Federal agencies to institute administrative proceedings and to levy civil penalties and assessments against persons who defraud the Government. The authority would be triggered when Justice declines to take action but recommends that the agency levy a fine. GAO has not had the opportunity to comment on the specific legislation being developed by Justice. However, GAO endorses the concept of allowing agencies to levy civil monetary penalties against those who defraud their programs.

RECOMMENDATION TO THE CONGRESS

GAO recommends that the Congress enact the Federal Managers' Accountability Act of 1981.

MATTERS FOR THE CONGRESS TO CONSIDER

The Congress should consider the merits of enacting legislation to allow agencies to assess civil monetary penalties against persons who defraud Federal programs. The authority to assess such a penalty should be effective when the Department of Justice declines to take criminal or civil action on a case.

RECOMMENDATION TO THE DEPARTMENT OF JUSTICE

The Department of Justice should expedite completion of its draft legislation to give agencies the authority to levy civil monetary penalties and should submit the legislation to the Congress for its consideration.

AGENCY COMMENTS

GAO gave each of the agencies covered in the review a chance to comment on a draft of this report. Ten agencies commented--nine generally agreed with the findings, conclusions, and recommendations; the Department of Transportation disagreed. Chapter 7 is an analysis of the comments. The text of each agency's comments is presented in appendixes II through XIV.

The Office of Management and Budget stated that fraud and abuse in the Federal Government must be controlled as quickly as possible and agreed that improved control systems can contribute significantly to solving the problem. The Office stated that it is reviewing the proposed legislation and is also considering administrative requirements for adopting and maintaining more effective internal control systems. (See pp. 61-62.)

The Department of Justice stated that this report reflects a balanced understanding of the Government actions required to effectively respond to the problem of fraud and abuse in Federal programs. In terms of the overall message, the

Department agreed that the cost of fraud and related illegal activities is substantial and that prevention of such activities through effective systems of internal control should be a top priority. The Department plans to continue pursuing this objective in its work with other departments and agencies. The Department believes that the report focused primarily on the efforts of other agencies, and provided a number of comments on some of its own more recent efforts as well as on what it perceived to be some inaccuracies and omissions. (See pp. 70-78.)

The Department of Transportation believes the report oversimplifies the solution to combating fraud by claiming that sound internal control systems are the answer to fraud and illegal activities. The Department also believes additional legislation to improve controls is unnecessary. GAO recognizes that internal controls cannot prevent all fraud, but believes that good systems of control can prevent much of it. GAO believes that the Federal Managers' Accountability Act of 1981 would further encourage agency heads to develop and enforce adequate internal control systems. (See p. 83.)

CHAPTER 2

FRAUD AND RELATED ILLEGAL ACTIVITIES ARE WIDESPREAD

Fraud and related illegal activities against the Federal Government are a widespread problem. Fraud has been detected in every agency in our review and in all types of activities within these agencies. Actual losses due to fraud and other illegal activities will never be known because most go undetected.

DIRECT DOLLAR LOSSES DUE TO FRAUD ARE SUBSTANTIAL

Based on statistical projections of the data compiled, we identified actual or estimated dollar losses in about 48,800 fraud cases. Using the available data we were able to project that known losses due to fraud in the 2-1/2 year period reviewed were between $150 and $220 million. As indicated earlier, this figure includes only those fraud cases investigated by Federal agencies. Our estimated dollar loss does not include cases where State or local jurisdictions had primary investigative responsibility. Some of those losses are substantial. For example, in 1977 we reported that the Federal Government was losing close to $600 million a year in the food stamp program because of overissued benefits. 1/ Complete and accurate nationwide data was not available on the percentage of these losses due to fraud, but at five food stamp projects we visited, available data showed that about half of the overissuances were classified as suspected fraud.

Agencies planned to recover only a small percentage of their losses

Overall planned recoveries were between 20 and 29 percent of total losses due to fraud. Courts ordered defendants to repay the Federal Government a total of nearly $14 million in about 1,500 cases. In about 13,000 cases, agencies planned to recover about $29 million through administrative actions, such as working out a repayment agreement with the culprit or taking it out of the culprit's retirement fund. However, the total planned recoveries of about $43 million were small compared to total losses of between $150 and $220 million.

Moreover, the fact that a court orders restitution does not necessarily mean the money is actually recovered. In one case we became aware of during our review, a General Services Administration (GSA) building management specialist took advantage of inadequate controls to establish a fictitious company which received

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1/"The Food Stamp Program--Overissued Benefits Not Recovered and Fraud Not Punished," CED-77-112, July 18, 1977.

about $300,000 in payments for services never performed. In a criminal proceeding the defendant pleaded guilty to embezzlement. In a later civil proceeding in August 1978, the Federal Government was awarded almost $613,000 under the Federal False Claims Act. The amount awarded included double damages and penalties for false statements. At the time of this report, the Department of Justice had been unsuccessful in its attempts to obtain payment of the award.

In another case, an individual embezzled nearly $16,000 in Law Enforcement Assistance Administration grant funds. The individual was sentenced to 3 years probation, required to perform 200 hours of community service, and required to repay the stolen money. However, it is doubtful that full restitution will ever be made because, under terms agreed to by the Office of Probation of the Federal district court handling the case, the individual is repaying the Government at the rate of $20 a month. Thus, it will take her about 65 years to repay the $16,000.

Although we did not attempt to determine the amounts agencies recovered through administrative actions, we believe that actual recoveries are much lower than planned recoveries. For example, agencies often set up repayment schedules which are not adhered to by the culprit. All too typical is the case where a welfare recipient obtained excess payments of over $8,000 from Social Security's Supplemental Security Income program. The individual agreed to repay the agency $3,000 to avoid prosecution, but agency officials told us they actually recovered only $50.

We did not, as part of this study, evaluate the problems agencies face in recovering losses due to fraud. However, we plan to do another study which will address how agencies can increase the recovery of fraud losses.

Small dollar frauds may indicate big problems

While the public is usually aware of highly publicized cases with large dollar losses, smaller dollar frauds must not be written off as immaterial because they may be the first symptom of serious internal control problems.

An example of such a case is a payroll fraud committed by a clerk at the Military District of Washington Finance and Accounting Office which disburses $1.5 billion a year.

The employee used her official position to have 12 fraudulent payroll checks totaling about $17,000 issued to two accomplices. She was able to commit the fraud because there was no separation of duties and no matching of persons paid with persons employed. Clerks had complete control over entering names on the payroll, issuing time and attendance cards, and removing names from the payroll.

As a result of a subsequent review, three more employees confessed or were found guilty of defrauding the same office of over $16,000. Two others in the office were also arrested for suspected fraud involving $95,000.

In an audit following the fraud discovery, we found that at least $308,000 in overpayments and erroneous payments had been made by the Finance and Accounting Office in question. We also found that payroll office personnel had made over $531 million in unsupported adjustments to accounting records to make them agree with figures reported to the Treasury Department. 1/

MANY DIFFERENT TYPES OF INDIVIDUALS AND ORGANIZATIONS COMMIT FRAUD

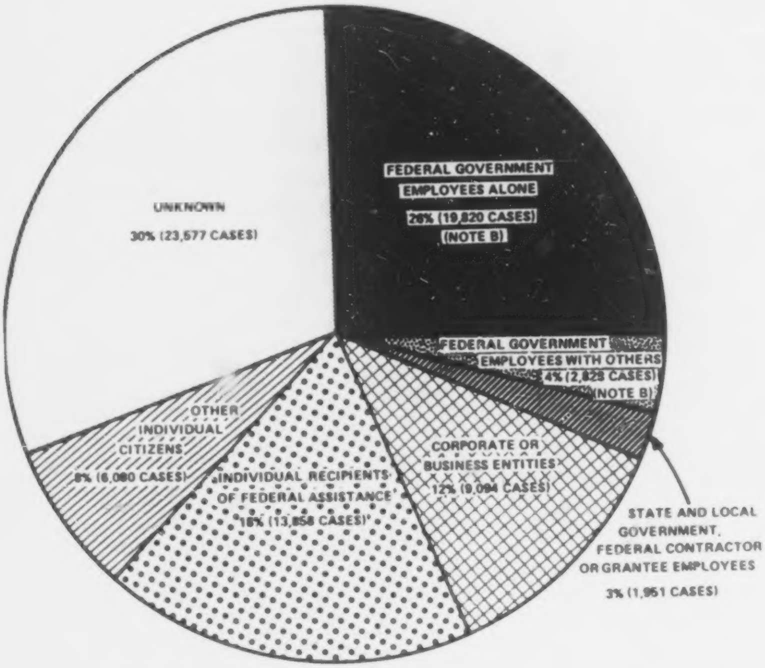
About 29 percent of the cases of fraud against the Government were committed by Federal employees. Consequently, the integrity of Federal employees is being closely scrutinized. The number of cases involving Federal employees is large. Even so, the Federal employees involved represent only about four-tenths of one percent of the Federal civilian and military personnel at the agencies covered by our review. In about one-quarter of the cases, individual citizens committed the fraud. Another 15 percent of the cases involved non-Federal organizations such as contractors, grantees, corporate recipients of financial assistance, and other business entities. In the remaining cases, the Federal agency was unable to identify the suspects.

Most of the cases where the Federal agencies were unable to identify the participants were theft cases. In some instances, noncompliance with established procedures or inadequate controls hampered agency attempts to identify suspects. For example, during a Department of Energy (DOE) audit 15 radios worth almost $8,000 were missing and were thought to have been stolen. An investigation could not identify any suspects because too many people had an opportunity to steal the items and two years had elapsed since the last inventory. Our review of controls revealed that keys to the storage area were accessible to many employees.

The chart on page 7 shows the participants in the fraud cases identified in the 21 agencies reviewed.

1/"Major Deficiencies in Army's Washington, D.C., Finance and Accounting Operations," FGMSD-80-53, June 5, 1980.

WHO COMMITTED FRAUD ?
(NOTE A)



a/Cases total 77,208 rather than 77,211 due to rounding and weighting of the data. Percentages on chart total 101 percent due to rounding.

b/Percentage of cases involving Federal employees totals 30 percent, rather than 29 percent, because of rounding.

FEDERAL AGENCIES HAVE BEEN SUSCEPTIBLE TO MANY TYPES OF FRAUD

As noted in our report "Federal Agencies Can, And Should, Do More To Combat Fraud In Government Programs" one of the prerequisites to controlling fraud is knowing where fraud has occurred and its extent. Our review was done, in part, to develop this information Government-wide.

Fraud occurred in all 21 departments and agencies included in our review. Agencies were susceptible to literally hundreds of different types of fraud in a wide range of functional areas.

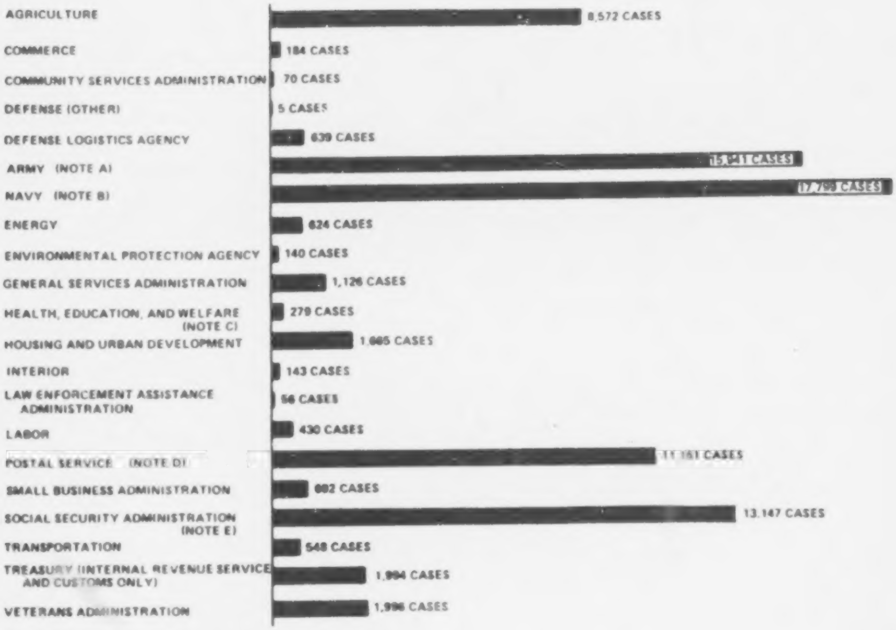
Statistical summary of cases by agency, functional area, and type of fraud

The following graphs present statistically developed numbers of fraud cases for each Federal agency we reviewed, and for the functional areas and types of fraud identified in these cases.

Analyses and conclusions based on the data presented must be carefully made. Several points should be kept in mind. We did not attempt to evaluate the investigative procedures used or the evidence developed, nor did we independently develop lists of fraud cases, or verify lists provided by each agency. As a result, conclusions that one agency has better fraud detection systems than another because it discovered more cases are not necessarily valid. It would also be incorrect to conclude that because one agency has identified more fraud than another it is more prone to fraud, less well managed, or otherwise not fulfilling its responsibilities.

As shown in the chart below, 66,620 cases or 86 percent of the detected fraud occurred in five agencies (Social Security Administration (SSA), U.S. Postal Service, Department of Agriculture, Department of the Army, and Department of the Navy). Theft was the most common type of fraud in the Postal Service, Army, and Navy. False statements were the most frequent fraudulent acts against SSA, and food stamp irregularities accounted for a majority of the cases in the Department of Agriculture.

FRAUD CASES BY AGENCY



a/Includes 307 Army-Air Force Exchange Service cases.

b/Includes the Department of the Navy and the Marine Corps.

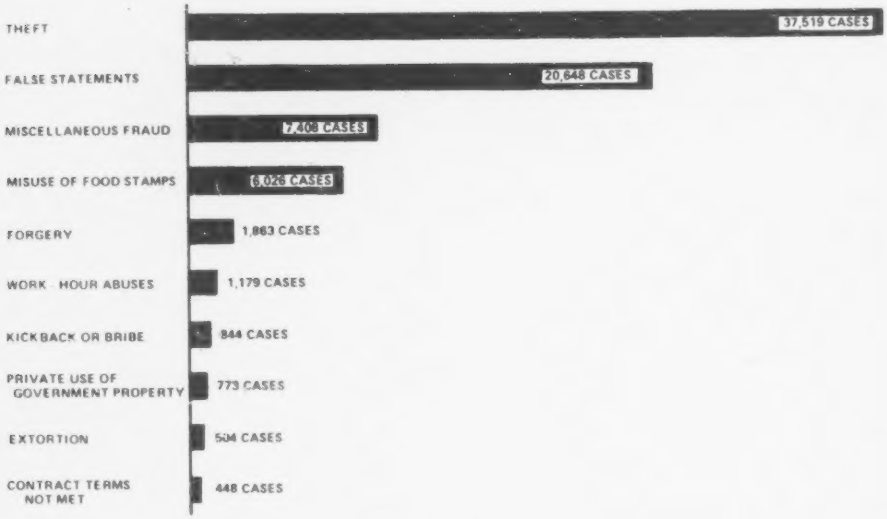
c/Since the period covered by our review, HEW has been reorganized. Its functions have been transferred to 2 new agencies—the Department of Education and the Department of Health and Human Services.

d/The cases in our Postal Service universe only represent a portion of the cases investigated by the Postal Service during the period of our review. Most of the cases we included in our universe were mail theft cases involving Postal employees or contractors. Other types of cases included such things as cash shortages at post offices, theft of supplies and equipment, fraudulent loss claims filed by Postal patrons, money order thefts, time and attendance abuses, and insufficient funds checks where there appeared to be intent to defraud the Service. We did not include cases involving the theft of mail once it was properly delivered to an address because there is usually no liability to the Postal Service in these cases. We also did not include burglaries and hold-ups. While we believe the cases we selected are the bulk of the cases that are of interest in this study they represent only a part of the cases investigated by Postal inspectors each year. For example, the vast majority of mail thefts occur after the mail is properly delivered, and over 90 percent of the persons arrested for the theft of mail in fiscal 1980 were non-Postal employees. According to Postal officials, the Service performed about 45,000 criminal investigations in fiscal 1980 which resulted in about 9,600 convictions for Postal offenses.

e/SSA was formerly part of HEW and is now part of the Department of Health and Human Services. For the purposes of our review, we treated SSA as a separate agency because it investigated and handled almost all the cases involving the Social Security Retirement and Supplemental Security Income programs.

About 93 percent of the cases involved theft, false statements, food stamp irregularities, and a wide variety of miscellaneous frauds. Destruction of Government property and insufficient funds checks were the most common types of miscellaneous fraud detected.

TYPES OF FRAUD COMMITTED AGAINST THE GOVERNMENT (NOTE A)

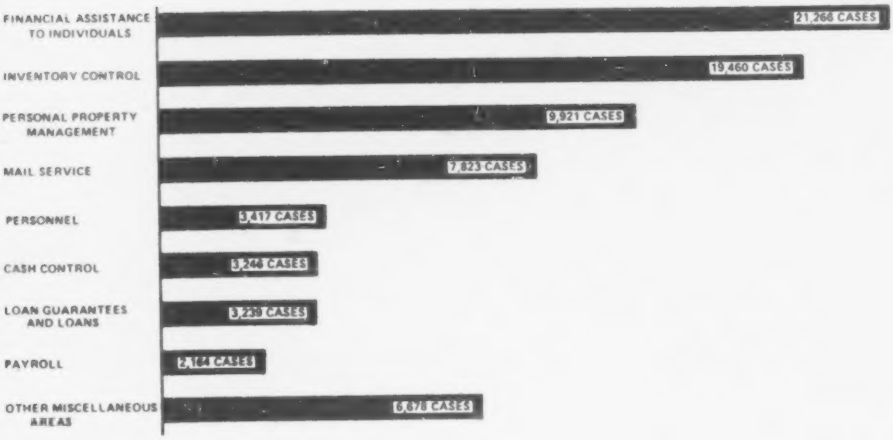


a/Cases total 77,212 rather than 77,211 due to rounding and weighting of the data.

As previously noted in the DOD definition (p. 2), theft is considered a type of fraud or illegal activity. It is viewed as a willful or conscious wrongdoing that adversely affects the Government's interests. As the above chart shows, theft accounted for almost half the cases identified by the agencies. In many theft cases we found that Federal agencies failed to adequately control and safeguard Government equipment and supplies. For example, at one DOE facility we evaluated 43 cases, most of which involved theft, and found internal control deficiencies to be a contributing factor in the majority. In one case, $327 worth of paper disappeared from a contractor's delivery drop point--an unsecured stairwell--at the facility. Although the amount of money involved was relatively small, officials said that they had a continual problem with items being stolen from this drop point. One contractor official said the contractor was lucky to get half of the items delivered to the stairwell. We found that the contractor did not require signed receipts for supply items and that these items were often left unsecured at delivery points making them highly susceptible to theft.

The next chart shows that 58,470 cases--about 76 percent of the total cases--occurred in four functional areas. The types of fraud most often associated with these functional areas were false statements and theft.

MAJOR FUNCTIONAL AREAS AFFECTED BY FRAUD (NOTE A)



a/Cases total 77,214 rather than 77,211 due to rounding and weighting of the data.

Examples of fraud cases in major functional areas

The cases presented in this section are typical types of fraud in the various functional areas. Dollar amounts identified do not, however, represent the normal or average loss. We included both large and small losses.

Financial assistance to individuals

Financial assistance to individuals is the most fraud-prone functional area identified. A typical case involved an individual who properly applied for and received mother and daughter survivors benefits after the death of her husband, a wage earner covered under Social Security. As part of the application, the individual agreed to notify the SSA when her daughter no longer qualified as a dependent. Under the program, the daughter would be ineligible if she married, and the payments received by the mother would be reduced accordingly.

The daughter married within 6 months after her mother filed for benefits. The mother did not notify SSA of the change in status and received over $4,300 in excess benefits. After pleading guilty to one count of fraud, she was sentenced to 6 months probation and ordered to repay the money to the agency.

Inventory control and property management

Inventory control cases involve the theft or misuse of Government property such as equipment, parts, vehicles, and supplies.

An example of a case affecting this function is one where a DOE research facility lost Government property costing about $130,000. Officials at the facility certified that the equipment was worthless and that it had been scrapped. However, a DOE inspector general investigator found no basis for the certification. About $68,000 worth of the equipment was later found and put back in the property inventory. The rest of the equipment was still missing at the time of our review.

Control over Government property at the facility was weak. At the time of our review, over $10 million in Government property at the facility had not been inventoried for 2-1/2 years.

Personal property management

The Department of Defense and other Federal agencies have general authority to reimburse their personnel for personal property stolen from, or damaged in, living quarters assigned by the Government up to a maximum of $15,000. The losses must be incident to the individual's service. A significant number of cases detected in the Departments of the Army and Navy involve the theft of personal property from military barracks.

The Department of the Army paid about $1.6 million in fiscal 1979 to claimants who had personal property stolen. Although statistics are not available for total claims paid by the Department of the Navy, we believe that the total, based on the number of cases detected, is probably substantial.

Mail service

The mail service cases we looked at consisted primarily of the theft of registered and insured mail. As indicated earlier (p. 9), we did not include the theft of mail after it was properly delivered because there is usually no liability to the Postal Service.

In one incident, Postal investigators suspected a clerk of stealing five mail pouches containing cash, coins, and jewelry. The individual was put under surveillance. He was subsequently tried, convicted, and sentenced to 3 years (with all but 3 months suspended) for thefts committed during the surveillance. The total loss to the Postal Service was about $112,000.

Personnel

The personnel cases involve the operations and activities of a department's personnel section such as improper hiring, firing, and promoting. False statements on employment applications are the most frequently encountered problem. For example, several DOD cases involved the fraudulent enlistment of illegal aliens into the Marine Corps. The aliens enlisted by presenting false birth certificates or other false proof of U.S. citizenship. In another typical case an Army recruiter, under pressure to fill his quota of enlistments, allegedly encouraged a recruit not to disclose his police record.

Cash control

The cash control functional area includes the use and control of Federal funds. Theft or embezzlement is the most frequent type of fraud in this area.

In one case a purchasing agent at a Veterans Administration (VA) medical center allegedly embezzled more than $60,000 from an imprest fund over a period of about 5 years. Imprest funds are cash on hand for the day-to-day miscellaneous financial needs of an agency. The agent allegedly covered the losses from the fund with fraudulent purchase orders for goods never delivered. Purchases made from the fund were supposed to be confirmed by certain other employees. However, the agent either got the individuals to verify that goods had been delivered without actually seeing them, or forged their signatures on receiving documents. The documentation he maintained to support purchases from the fund did not include vendor receipts as required by Federal Procurement Regulations. However, the lack of adequate documentation was not questioned during audits and management reviews of the fund over the 5-year period during which the fraud occurred.

The agent was finally caught because the medical center implemented a centralized accounting and management system. Shortly after the system was implemented, a pharmacist discovered that the pharmacy account was being charged for drugs never received, and reported the matter to the appropriate VA officials.

Loans and loan guarantees

Many Federal agencies administer programs which provide direct loans or loan guarantees to individuals and organizations who meet certain criteria. For example, the Small Business Administration (SBA) makes loans to small businesses. VA and the Department of Housing and Urban Development (HUD) guarantee home mortgage loans for qualified home buyers.

A typical case in this area is one where an individual borrowed $30,000 from SBA to buy a business. The borrower actually only paid $12,000 for the business. He allegedly used the rest of the money for purposes other than those allowed in his loan agreement.

Another example of problems in this area is the case of loan guarantees that were issued to nonveterans and ineligible veterans because of collusion between a real estate broker and a VA eligibility clerk. The eligibility clerk allegedly accepted numerous bribes from the real estate broker to issue phony certificates of eligibility for veterans benefits. These certificates were then used to obtain over 100 home loan guarantees for ineligible individuals. A VA investigation of one lending institution which provided loans to 47 individuals purchasing homes through the broker showed that over half the borrowers receiving VA guaranteed loans were not actually veterans.

Payroll

Payroll preparation, processing, distribution, and related activities are common areas of fraud, waste, and abuse. Working hour abuses and false statements on time and attendance documents are the most frequent problems.

In one case, a Government employee assigned to a Social Security Administration branch office was responsible for maintaining time and leave records and sending the information to HEW's central payroll office. The individual added fraudulent overtime hours to her own payroll data before sending it. This same individual also distributed the payroll checks. The fraud was only detected because the timekeeper was absent on a day when the payroll checks were received for distribution. Her supervisor distributed the checks and noticed the timekeeper was receiving excess pay. The individual received $3,200 in fraudulent overpayments before being caught.

Miscellaneous areas

A large number of cases fell into a wide range of other functional areas. For example, about 2 percent were in law enforcement and in travel. About 1 percent were in procurement and disposal of surplus property. All the rest of the functional areas affected represented less than 1 percent of the total cases.

THE NONMONETARY EFFECTS OF FRAUD ARE SUBSTANTIAL

The cost of fraud and other illegal activities cannot always be measured in dollars. Nonmonetary effects must also be considered in evaluating the seriousness of incidents of fraud against the Government.

Possibly the most serious nonmonetary effect is the loss of confidence in the Government's ability to efficiently and effectively manage its programs. This occurs when members of the public believe that individuals can commit illegal acts without fear of prompt, or possibly any, Federal action. Such perceptions, whether valid or not, can result in the view that such activities are the norm.

In over 14,000 cases where no money was lost, individuals did not receive the benefits intended or they received benefits for which they were not eligible. An example is the case where a grocery store accepts food stamps for ineligible items such as beer, wine, and cigarettes. In other cases, veterans sometimes act as "straw buyers" and obtain VA guaranteed home loans for nonveterans. Under this scheme, a veteran purchases a house using his or her VA benefits and then turns the property over to the real buyer. In many of these cases it is difficult to pinpoint a direct dollar loss, but individuals or organizations are clearly receiving benefits to which they are not entitled. Violations such as these threaten program integrity and could lead to the eventual cancellation of the programs involved and loss of benefits for the program participants who obey the rules.

Fraud also has other serious effects which more directly affect people's lives. In about 630 cases the fraud had a potentially harmful effect on public health and safety. A good example is the case where the superintendent of a municipal wastewater treatment plant and at least three other people were involved in a scheme to falsify discharge reports required by Federal law. The individuals intentionally dumped raw sewage into a river and then falsified reports to the Environmental Protection Agency (EPA) on the amount of sewage released.

CHAPTER 4

EFFECTIVE PUNITIVE ACTIONS ARE NOT ALWAYS TAKEN AGAINST THOSE WHO COMMIT FRAUD

It is highly likely that many who commit fraud go unpunished. There are three reasons for this:

- --Criminal prosecutions by the Department of Justice are not always possible or desirable.
- --Justice may not fully pursue civil remedies against those who commit fraud.
- --Federal agency officials do not always take effective administrative actions to punish offenders.

The statistics contained in this chapter are based on 72,797 closed cases where there was some evidence that fraud had occurred and the action taken was the total and final action.

MANY CRIMINAL CASES ARE NOT PROSECUTED

Every year about 200,000 cases of all types of Federal crime including fraud are referred to the Department of Justice for prosecution. With only about 1,600 prosecutors, fewer than those employed in either the State of New York or the State of California, the Department cannot possibly prosecute all the cases referred. Even if the Department could handle all the cases referred, the already overloaded court system would be swamped. Also, more prosecutions would provide an additional burden on the Federal prisons and correctional institutions. Given its limited resources, Justice usually attempts to concentrate on cases which it perceives to have maximum impact and deterrent value. According to our projections, the Department of Justice declined to prosecute about 7,800 cases, or 61 percent, of the nearly 12,900 fraud cases agencies referred for prosecution over the 2-1/2 year period covered by our review.

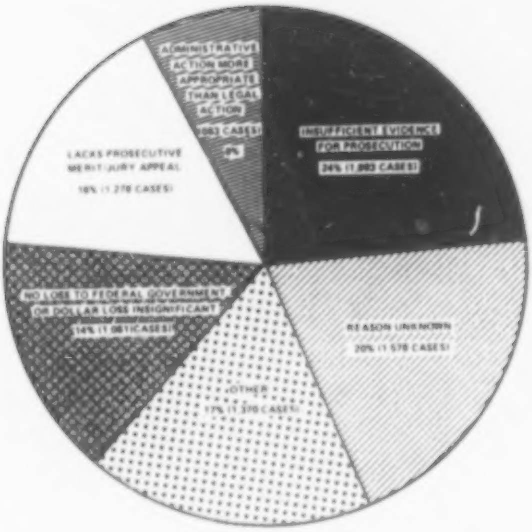
Reasons given by Justice for declining cases

As shown below the reasons most frequently given by Justice for declining cases were related to the adequacy of evidence, the case's prosecutive merit or jury appeal, and the financial loss resulting from the alleged fraud.

WHY THE JUSTICE DEPARTMENT HAS DECLINED TO PROSECUTE CASES

(7,843 CASES)

(NOTE A)



a/Percentage of cases totals 99 percent due to rounding.

Almost a quarter of the cases were rejected for lack of sufficient evidence. We did not attempt to evaluate the adequacy of the investigations of these cases, or the reasonableness of the declination justification.

About 16 percent of the cases were rejected because they lacked prosecutive merit or jury appeal. "Prosecutive merit" and "jury appeal" have no precise definitions. In these cases U.S. attorneys concluded that, for overriding reasons, prosecution should not be initiated.

U.S. attorneys or Department of Justice headquarters declined to prosecute about 14 percent of the cases because they considered the dollar loss insignificant or there was no loss to the Government. Also, the amount of financial loss to the Government was often a consideration in declining other cases even when it was not the primary reason.

U.S. attorneys and Justice headquarters declined about 8 percent of the cases because they thought agency administrative punitive actions would be more appropriate than legal action. Agencies eventually took administrative action in over 94 percent of the cases declined for this reason. (See pp. 34-38 for a discussion of the administrative actions taken.)

JUSTICE HAS ESTABLISHED PRIORITIES FOR PROSECUTING WHITE COLLAR CRIME

In August 1980, the Department published national white collar crime law enforcement priorities. Among other things, the priorities are intended to improve the coordination and allocation of limited Federal resources for investigating and prosecuting white collar crime, including fraud against the Government, and to make Federal law enforcement more consistent. Justice intends that the national priorities should be viewed by Federal investigators and prosecutors as indicators of the types of white collar crime that deserve special emphasis.

With respect to fraud against the Government, the new Justice Department priorities emphasize prosecuting fraud cases involving corruption of Federal officials and those fraud cases involving private citizens, acting alone or as part of an organization, which resulted in losses of $25,000 or more. It appears that at least a quarter of the total prosecuted cases in our review might not have been prosecuted had the new guidelines been in effect. These were cases which involved private citizens, and resulted in losses of less than $25,000.

In commenting on a draft of this report, the Department of Justice pointed out that the white collar crime priorities are not intended to be guidelines for declining cases. According to the Department, it has emphasized to Federal prosecutors and Federal investigators that the white collar crime priorities describe the types and magnitude of cases that should receive special attention, that priority cases may be few in number, and that cases which may not fall strictly within the priority specifications may nevertheless be very important. In addition, the Department is having each U.S. attorney develop additional priorities to meet the specific needs of his or her own district. According to Justice, as U.S. attorneys define their respective districts' white collar crime priorities, they may, with the Department's approval, deviate somewhat from the national priorities. Therefore, the Department of Justice believes it is not possible to precisely predict the effect of the national and district priorities on the types of cases accepted or declined for prosecution. However, the Department does agree that the priorities will probably mean it will prosecute fewer small dollar fraud cases. We believe, and Justice agrees, that this makes it even more important for agencies to take effective administrative actions against those who defraud agency programs.

JUSTICE IS VERY SUCCESSFUL IN PROSECUTING CASES

In our sample, Justice got a conviction or guilty plea in 95 percent of the over 4,300 criminal cases it decided to prosecute. In addition, Justice handled about 680 cases through pretrial diversion. Pretrial diversion is a voluntary program which removes suspects from the criminal justice process before trial and places them in a program of supervision, generally by the Federal Probation Service, for a specified period. Successful participants have the charges against them dismissed. We did not obtain information on the number of individuals who successfully completed pretrial diversion.

The Government relies on specific criminal fraud statutes which are suited to a particular fraud, and three general criminal fraud statutes. The three general fraud statutes are the conspiracy to defraud statute (18 U.S.C. 371), the false claims statute (18 U.S.C. 287), and the false statement statute (18 U.S.C. 1001). Fines and sentences vary, but generally the maximum is a $10,000 fine and a jail term of not more than 5 years. Although most cases are prosecuted under these general statutes, we did not collect data on the statutes under which each case in our sample was prosecuted.

In over 90 percent of the 4,100 cases the Justice Department successfully prosecuted, the courts handed down prison sentences. Some cases involved more than one defendant, and a total of about 4,200 persons were sentenced to prison. The courts often suspended large portions of the sentences or granted probation. About a third of those sentenced actually spent time in prison. The following table shows the time individuals were sentenced to serve in prison. Information on how much time the individuals actually spent in prison before parole was not readily available.

Length of sentences (note a)	Number of individuals (note b)	Percentage of total cases
6 months or less	485	57
7 months to 1 year	39	5
13 months to 2 years	74	9
25 months to 3 years	129	15
More than 3 years (note c)	122	14
Total	849	100

a/Excludes portions of sentences suspended or to be served on probation.

b/Data on the length of sentences was only available on 849 of the 1,337 cases where individuals were sentenced to prison.

c/The longest sentence was 13 years.

In about 1,200 cases the courts fined defendants as shown below.

Amount of fines	Number of cases (note a)	Percentage of total cases
$1,000 or less	631	65
$1,001 to $5,000	198	20
More than $5,000 (note b)	139	14
Total	968	99 (note c)

a/Data on the amount of fine was only available in 968 of the 1,158 cases in which courts levied fines.

b/The largest fine was $200,000.

c/Does not total 100 percent due to rounding.

JUSTICE MAY NOT FULLY PURSUE CIVIL REMEDIES

In some instances, civil remedies may be a greater deterrent than criminal prosecutions because civil remedies may be more commensurate with the damage caused by the fraud. Civil remedies are available both in statute and in common law. The principal civil fraud statute is the False Claims Act. The False Claims Act empowers the United States to recover double damages from those who knowingly make false claims for money or property upon the United States, or who submit false information in support of claims. In addition, the United States may recover one $2,000 forfeiture for each false claim submitted or for each false document submitted in support of a claim. The Department of Justice has proposed changes to the False Claims Act to make it easier to prosecute cases under the act and to provide for stiffer penalties.

In 1979 we completed a study of the Department of Justice's handling of fraud cases with emphasis on the civil aspects of program fraud. 1/ We did the review at nine judicial districts and Justice Department's Civil Division. We found that the Department had not emphasized the civil aspects of fraud cases. Our current study provides additional support for this conclusion. During our 2-1/2 year review period the Department of Justice only filed 28 civil actions out of a total of 393 fraud cases in our universe referred by agencies for civil legal action.

1/"Department of Justice Should Coordinate Criminal and Civil Remedies to Effectively Pursue Fraud in Federal Programs," GGD-80-7, Oct. 25, 1979.

In 1979 we reported that in many fraud cases little consideration, if any, was given to potential civil remedies until after a criminal case was completed. As a result, civil remedies often were not timely, making the total prosecutive effort less efficient and reducing the chance for recovering losses.

We further reported in 1979 that Justice's tradition of giving preeminence to criminal sanctions continued to be implemented in such a manner that the decision to proceed against fraud was made without early consideration of available civil remedies. We also reported that Justice had not provided adequate guidance to address attorneys' concerns about legal barriers to early consideration of civil sanctions, nor had Justice developed an effective referral system to help ensure that fraud cases were reviewed for civil prosecution at an early stage.

In commenting on a draft of this report, the Department of Justice pointed out recent developments in civil and criminal coordination of fraud cases. Justice stated that in recognition of the fact that the investigators and auditors who develop the evidence necessary to bring a civil or a criminal action are a key factor, the Department's Civil Division attorneys have been presenting two to four seminars each month for agency personnel for over a year. Most often, these seminars are given in connection with presentations by Justice criminal attorneys. Justice also noted that it plans to give an indepth course in civil litigation to U.S. attorney personnel this year.

According to the Department, the chiefs of various Civil Divisions of United States attorneys' offices have exchanged plans for the coordination of civil and criminal fraud cases. The Department stated that many of these plans are now functioning and involve early consideration of civil remedies. Justice also said a civil fraud course is being added to the Law Enforcement Training Center's seminar on white collar crime. 1/

According to the Department, a reorganization of the Civil Division has improved anti-fraud activities. The Department stated that more civil attorneys are handling fraud cases and the number of persons screening incoming reports on fraud has quadrupled.

We have not verified the accuracy of these statements. However, we plan to initiate a review of Federal agency efforts to

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1/The Federal Law Enforcement Training Center in Glynco, Georgia, is run by the Department of the Treasury. Since December 1978, the Center, in concert with a number of Federal organizations has sponsored a 2-week seminar on white collar crime. The program was developed specifically for experienced investigators, auditors, and others actively combating fraud, waste, and abuse in Government programs. To date, over 1,100 people from over 50 organizations have graduated from this program.

recover losses due to fraud which will include agency actions to take civil remedies against those who defraud their programs. As part of this review, we will examine the improvements that the Department of Justice has made in coordinating civil and criminal prosecutions.

AGENCIES DO NOT ALWAYS TAKE EFFECTIVE ADMINISTRATIVE ACTIONS

In about 27 percent of the over 47,000 cases where agencies were able to identify suspects, they did not take any administrative action. 1/ However, in about 2,000 of the cases where no administrative action was taken, individuals were prosecuted. In the remaining 11,000, or 22 percent, of the cases no action at all was taken.

In about a third of the cases where the information was available, the reason most often given by agencies for not taking administrative action was that they did not believe they had adequate evidence. In another 10 percent of the cases, the suspect employees resigned and the agencies felt the cases were not worth pursuing. Agencies gave a wide variety of reasons for failing to act in the remaining cases.

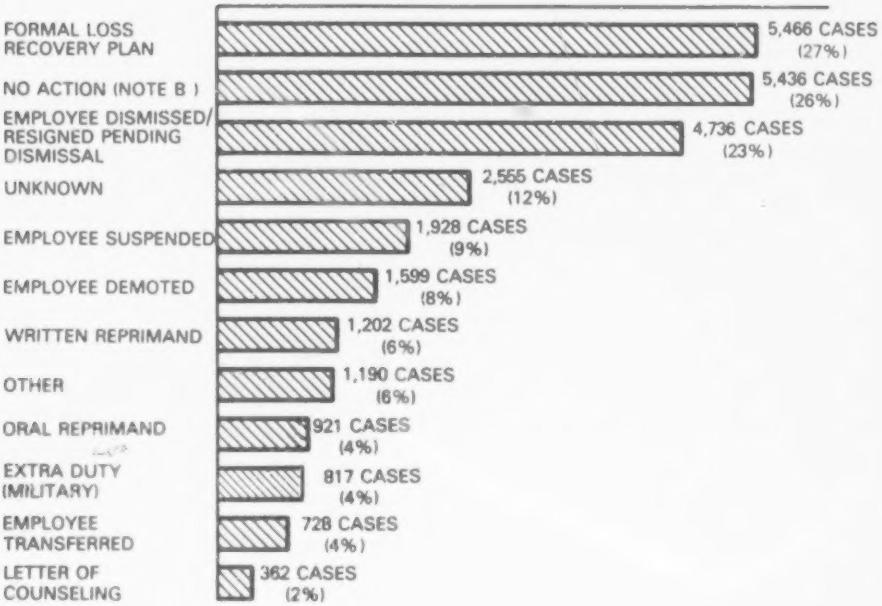
Administrative action against Federal employees

Agencies took some administrative action in about 74 percent of the cases involving fraud by Federal employees. In many cases agencies took more than one type of action. In about 23 percent of the cases, agencies either fired employees or employees resigned when notified they were being dismissed. In a little over a quarter of the total cases, agencies took administrative action to recover all or part of the loss. The chart on page 35 shows the types of actions taken.

1/In 3,148 cases where suspects were identified we were unable to determine if any action was taken.

ADMINISTRATIVE ACTIONS AGAINST FEDERAL EMPLOYEES

(20,582 CASES) (NOTE A)



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a/The percentage of actions taken total over 100 percent of the 20,582 cases because in 4,345 instances agencies took more than one administrative action. For example, in 580 cases, agencies fired employees and also took action to recover losses.

b/In 413 of these cases, legal action was taken.

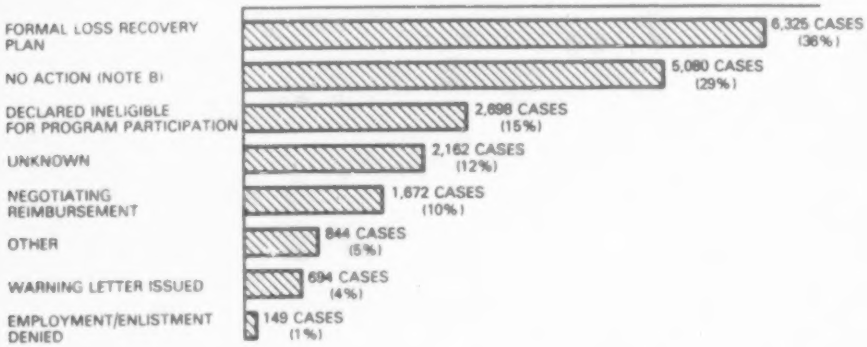
Administrative actions against individuals and organizations outside the Federal Government

The Federal Government can also take administrative action against outside individuals and organizations. These remedies are, however, often less effective than those available against Federal employees.

Overall, Federal agencies took administrative actions against individuals and organizations about 71 percent of the time. Most of these actions were to correct a specific situation and would probably not deter others from committing fraud against the Government. For example, in about 36 percent of the cases involving individuals, the agencies affected took action to recover funds. We agree that agencies should take aggressive actions to recover funds, but such recoveries in themselves provide little deterrence for others considering fraud.

Next to recovering losses, declaring persons ineligible for program participation was the second major type of administrative action taken against individual citizens. Individuals were declared ineligible for program participation in about 15 percent of the cases. The deterrent effect of this action is questionable, since many of the individuals were not eligible for the programs in the first place.

ADMINISTRATIVE ACTIONS
AGAINST INDIVIDUALS
(17,536 CASES) (NOTE A)

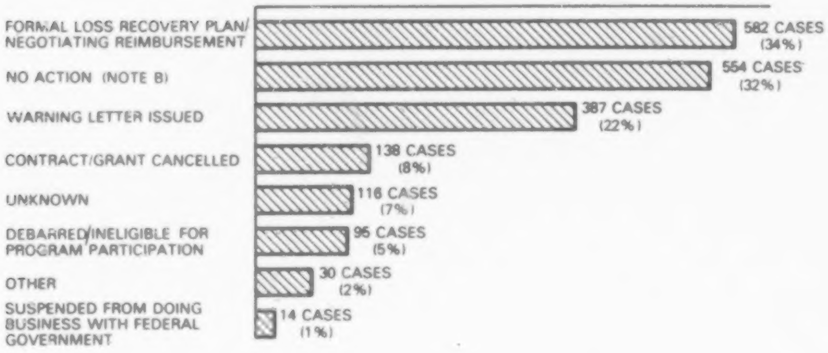


a/The percentage of actions taken total over 100 percent of the 17,536 cases because in 2,051 instances agencies took more than one administrative action.

b/In 1,177 of these cases, legal action was taken.

When Federal contractors, grantees, or State and local governments were involved, agencies attempted to recover the losses in about 34 percent of the cases. In about 22 percent of the cases they sent the organization a warning letter. Agencies cancelled contracts and grants in only 8 percent of the cases. In another 6 percent of the cases, organizations were suspended, debarred, or declared ineligible for program participation.

ADMINISTRATIVE ACTIONS AGAINST CONTRACTORS, GRANTEES, OR STATE AND LOCAL GOVERNMENTS
(1,735 CASES) (NOTE A)



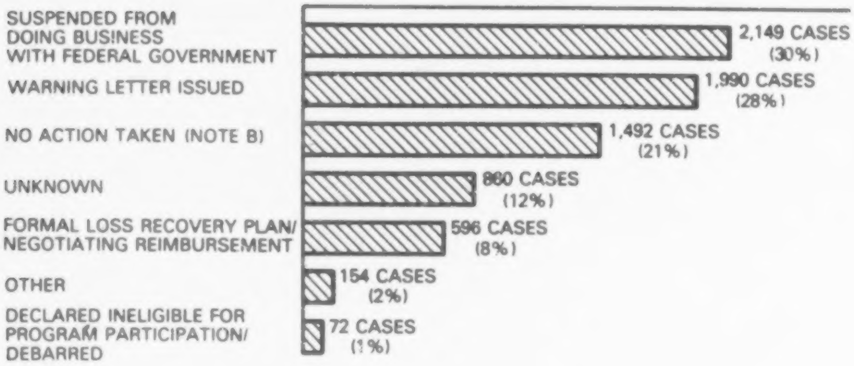
a/The percentages of actions taken total over 100 percent of the 1,735 cases because in 179 instances agencies took more than one administrative action.

b/In 132 of these cases legal action was taken.

Many businesses other than contractors were involved in the frauds. Examples include grocery stores selling ineligible items for food stamps, pharmacies overcharging on medicaid prescriptions, and lending institutions falsifying applications for federally guaranteed loans. In a little over a quarter of these cases, the organizations were suspended from doing business with the Federal Government. In another quarter of the cases, agencies sent the businesses warning letters.

ADMINISTRATIVE ACTIONS AGAINST BUSINESSES OTHER THAN CONTRACTORS

(7,200 CASES) (NOTE A)



a/The percentages of actions total over 100 percent of the 7,200 cases because in 148 instances agencies took more than one administrative action.

b/In 256 of these cases, legal action was taken.

Civil monetary penalties may be an alternative to prosecution

We believe that Federal agencies should aggressively use available administrative remedies against perpetrators of fraud. In addition, we believe that civil fine authority could be a useful enforcement tool for agencies in those cases where the Department of Justice declines to initiate criminal prosecution or civil suits. Giving certain agencies the authority to levy civil monetary penalties against those who defraud their programs could serve as a strong deterrent against would-be perpetrators of fraud against the Government.

Legislation has been introduced to provide this authority to certain agencies. The Civil Money Penalty Bill (H.R. 4106), which was introduced in the Congress in 1978, would have permitted the Secretary of the former HEW to apply a penalty of up to $2,000 for each fraudulent claim submitted to the medicaid or medicare programs, and to impose a fine double the amount of such claim. The Secretary could apply the penalties in situations where criminal prosecution was unwarranted or impractical.

More recently, the Federal Property and Administrative Services Act Amendments of 1980 was introduced in the 96th Congress to reform GSA contracting procedures and contract supervisory practices. Among other things, the legislation would have required GSA contractors to certify the truth and completeness of information required to be furnished to the Government. The contractor would be required to certify that

--all material information has and will be furnished;

--the material information furnished is not false, misleading, or incomplete; and,

--the contractor will not furnish false information or fail to furnish revisions of prior submissions to maintain their validity and completeness.

The legislation would have allowed the GSA Administrator to assess a penalty against any person violating the certification. The penalty could range from $1,000 to double the contract price, depending upon the severity of the miscertification.

Neither bill was passed. However, they illustrate the types of civil monetary penalties that could be imposed by agencies.

The Department of Justice is now completing draft legislation which would allow agencies to levy civil monetary penalties in cases under $50,000. Under the legislative proposal being considered, the authority would be triggered when the Department of Justice declines to take action in favor of this remedy. In commenting on a draft of this report, Justice said that the remedy is contemplated to be a substitute for civil legal action, but is not intended to replace a criminal prosecution, if appropriate. Under the proposal being considered, a matter could be the subject of criminal prosecution and administrative penalty action. Justice also suggested that the Congress should enact legislation authorizing the offset of tax refunds to recover damages caused by fraud. We have actively supported the concept of offsetting debts against tax refunds.

We have not had the opportunity to comment on the specific legislation being developed by Justice. However, we endorse the concept of allowing agencies to levy civil monetary penalties, where appropriate, against those who defraud their programs. We believe the Congress should consider the merits of enacting legislation to allow agencies to assess civil monetary penalties against persons who defraud agency programs when the Department of Justice has declined to initiate criminal prosecutions or civil action.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

Fraud is a costly and widespread problem. Once an agency allows fraud to happen, chances are it will never recover the loss. Not only is fraud expensive in terms of dollars and cents, but it also undermines the integrity of Federal programs and makes people lose confidence in public institutions.

Good systems of internal controls would prevent much of the fraud, or would at least result in its earlier detection. Controls over Federal programs are, however, often inadequate, nonexistent, or ignored. Further, Federal managers are often unconcerned with enforcing the controls needed to prevent frauds. Fraud can flourish in such an environment.

Much fraud is detected by chance. Given the poor state of controls in many programs, it is probable that most frauds remain undetected. For those who are caught committing fraud, the chances of being prosecuted and eventually going to jail are slim. Further, agencies do not always use the administrative actions available to deter persons from committing fraud. The sad truth is that crime against the Government often does pay.

Agency inspectors general, along with the Department of Justice, are working to improve the situation. They have initiated programs not only to increase the detection of fraud, but also to improve controls to prevent it. Even so, much more needs to be done.

We believe agencies should emphasize fraud prevention, rather than simply pursuing it once it occurs. Prevention is especially important, since only a low percentage of suspects are prosecuted and agencies often fail to take effective administrative actions against those who commit fraud.

In our view, the Congress' oversight responsibility can be exercised to a greater and more effective degree by strengthening existing law. The Congress is currently considering legislation entitled the Federal Managers' Accountability Act of 1981 that would require greater accountability by heads of Federal agencies for the effectiveness of their organizations' systems of internal financial control. Among other things, the legislation would require agency heads to periodically evaluate the adequacy of their internal control systems and report the results to the Congress and the President. We would participate in this process by providing guidance for conducting the examinations and by reviewing the results. We believe this legislation would contribute to the development of adequate internal control systems in the Federal Government.

We also believe that more needs to be done to assure that those who commit fraud are adequately punished. We recognize that the Department of Justice cannot prosecute every case referred. This makes it even more important that Federal agencies take effective administrative actions where warranted. In addition, we believe that civil fine authority could be a useful enforcement tool for agencies in those cases where Justice does not take criminal or civil action. We believe the Congress should consider the merits of enacting legislation to allow agencies to assess civil monetary penalties when the Department of Justice declines to take criminal or civil action against persons who defraud agency programs.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress enact the Federal Managers' Accountability Act of 1981.

MATTERS FOR THE CONGRESS TO CONSIDER

We recommend that the Congress consider the merits of enacting legislation to allow agencies to assess civil monetary penalties against persons who defraud Federal programs. The authority to assess such a penalty should be effective when the Department of Justice declines to take criminal or civil action on the case.

RECOMMENDATION TO THE DEPARTMENT OF JUSTICE

The Department of Justice should expedite completion of its draft legislation to give agencies the authority to levy civil monetary penalties and should submit the legislation to the Congress for its consideration.

JOINT STATEMENT ON BEHALF OF
THE STATUTORY INSPECTORS GENERAL
IN SUPPORT OF
GOVERNMENT-WIDE AUTHORITY
FOR
FRAUDS AGAINST THE GOVERNMENT

June 18, 1985

Submitted by Richard P. Kusserow
Chairman, Legislation Committee
President's Council on Integrity
and Efficiency

With this statement, the statutory Inspectors General[1] hereby offer their unanimous support for a government-wide administrative mechanism to impose civil monetary penalties for false claims and statements made to the United States. As the Federal officials who are charged with the formidable task of preventing and detecting fraud and abuse in their respective agencies, the Inspectors General strongly believe that the proposed civil monetary penalties authority will provide an invaluable tool in their efforts to combat fraud against the United States. It will also contribute to furthering the Administration's management reform initiatives, known as Reform 88.

Under current law, the principal remedies for fraud against the Federal government are criminal prosecution and civil litigation. Both sanctions require the participation of the Department of Justice and resort to the Federal courts. However, the Justice Department simply does not possess the resources necessary to prosecute all cases referred to it by the Inspectors General and others. Further, certain cases may lack prosecutive merit for a variety of reasons -- for example, loss to the government is small or impossible to calculate; insufficient jury appeal; insufficient evidence to support a criminal prosecution; and a host of other factors. And, where the dollar value of a case is relatively small, civil litigation under the False Claims Act may be inappropriate since the Government's cost of litigation would exceed any potential recovery. Often, then, the Government is left only with the administrative remedies of suspension and debarment. Though important, these sanctions are frequently inappropriate, and do not offer the United States the opportunity to recoup its losses, both actual damages and consequential damages such as costs of detection and investigation. As a result, many instances of fraud against the government go unpunished.

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[1] A list of the Inspectors General contributing comments for this Joint Statement is included as an Appendix hereto.

Where the Department of Justice does opt to take civil action against a wrongdoer, litigation often takes an inordinate time to pursue through the U.S. District Courts. Such "justice delayed" not only costs the government dearly in the expenses associated with protracted litigation, but also, we believe, dilutes the deterrent effect of the remedial action.

The bill under consideration by the Committee today, S. 1134, offers an alternative to judicial remedies for fraud -- an alternative that promises numerous benefits to the Federal government. First, the civil monetary penalty authority would act as a powerful deterrent, particularly in those types of cases in which the Department of Justice does not pursue civil action or criminal prosecution. Vigorous use of this sanction authority by all Federal agencies would dispel the perception that "small" frauds against the United States may be committed with impunity. Second, an administrative mechanism for resolution of fraud cases is both expeditious and relatively inexpensive. Thus, victimized agencies may move swiftly to penalize fraud, thereby protecting the integrity of the programs against ongoing fraud. Third, an administrative alternative will relieve the Department of Justice of the burden of "smaller" fraud cases, thereby freeing that Department to more effectively allocate its own resources. Such a distribution of responsibility can only strengthen the overall efforts of the Federal government to control fraud. And finally, the proposed civil monetary penalties authority would provide the government with the means of recovering sums that have heretofore been irretrievably lost to fraud.

For the above reasons, the Inspectors General would welcome civil monetary penalties as an additional tool to recover federal funds misspent as a result of false claims and statements, and to deter future fraud.

In order to emphasize the utility of and need for an administrative mechanism for resolution of fraud cases, various Inspectors General have submitted the following examples of cases -- some very specific, others, general descriptions of categories of cases -- that would appear suitable for such administrative proceedings:

National Aeronautics and Space Administration

- The President of a Small Business section 8(a) Contractor, a Chapter S Corporation, charged personal expenses through the company's overhead accounts to a NASA cost-reimbursable contract. These personal expenses consisted of false claims on public vouchers of approximately $27,000. The expenses were purportedly related to official business, when in fact they consisted of costs associated with personal use of a Mercedes Benz and a Cadillac by the corporate president and his spouse. Since government auditors disallowed the expenses on the NASA contract, the Assistant U.S. Attorney declined prosecution on the ground that there was, therefore, no financial loss to the government. Under the proposed program fraud legislation, the corporation and/or individual could be liable for a civil penalty of up to $10,000 for each false claim plus an administrative assessment of not more than double any amounts claimed.

- A contractor employee was transferred cross country to work on a NASA contract. He submitted a receipt, signed by the purported landlord, for claimed rental expenses to be reimbursed by his employer. These costs would ultimately be borne by the government under the NASA contract. In fact, the employee did not rent the apartment but merely moved in with his girlfriend. The landlord signed the false receipt as a "favor to a friend." Afterwards, the employee doctored the original receipt in order to receive additional reimbursement on a second claim. Prosecution was declined because the employee is making restitution, he had no prior criminal record, there was "minimal federal interest," and there would be a necessity to transport witnesses cross country at a cost disproportionate to the false claims totalling $1,626. Under the program fraud bill, penalties and assessments could be levied.

Department of Energy

- Based on questions raised in a DCAA audit report, the IG engaged in a two year investigation of a contractor to a DOE grantee. The contract was to provide an energy storage system to the grantee to be used in connection with a solar-powered building funded by the Department of Energy. Investigation showed that the contractor had charged numerous personal expenses to the contract. These expenses included the repayment of private, personal loans and purchase and maintenance of a Cessna aircraft as well as payment for personal travel and legal services. Due to perceived evidentiary problems, i.e., lack of identity of Federal funds, the Department of Justice declined both criminal and civil action. The procedures provided in the program fraud bill would have facilitated recovery of the substantial loss in this case.

Department of Transportation

- The bill would appear to free Federal agencies from some legal obstructions that presently exist within title 18 of the U.S. Code and the False Claims Act, such as the requirement that an injury must be sustained by a Federal agency or department. Thus, under the proposed S. 1134, the Department of Transportation would be able to bring false claims actions against bid riggers on Federal-aid highway and airport projects, notwithstanding the decision in U.S. v. Azzarelli Construction Company, 647 F.2d 757 (1981). In Azzarelli, the U.S. Court of Appeals held that in view of the fact that the Federal contribution to highway construction in Illinois for the year in question was a fixed sum, there was no monetary injury sustained by the United States to permit a recovery despite the fact that project costs had been inflated due to the bid rigging conspiracy. Where the false claims do not exceed $100,000, action could be brought under the program fraud bill. This could result in substantial direct dollar recoveries for the Department, as bid rigging investigations are their highest priority and most successful area of investigation.

Veterans Administration

- The proposed civil monetary penalties authority could be used to redress beneficiary entitlement fraud. The Department of Justice has been reluctant to pursue criminal prosecution of recipients involved in beneficiary entitlement fraud since they are often elderly or disabled. For example, during the past year, 293 VA cases involving fraud in excess of $1,000 each were declined by the Department of Justice, including 224 compensation and pension cases. The proposed penalties and assessments in this legislation could be applied in some of these cases, where the beneficiaries have financial resources to pay.

Department of Commerce

- Civil penalties authority will help in cases where no dollar loss to the government can be readily ascertained. For example, the Department has cases where contracts or financial assistance awards are based on documents that contain false statements. In many cases, the Department cannot determine the connection between the false statement and the Department's decision to enter into the contract, grant or loan. Although such an award results in no monetary loss to the government, the integrity of the procurement or financial assistance process is greatly damaged once the false statement has been uncovered. These contractors should be held responsible for their actions. A monetary penalty for this type of corruption would act as a deterrent to others who would seek to mislead the government.

Department of the Interior

- The following are examples of cases that have been declined for criminal prosecution and civil action, that would be appropriate for imposition of civil penalties under the program fraud bill. First, a contractor with the Bureau of Indian Affairs submitted inflated billings in connection with services performed under the contract. Total overbillings were in the vicinity of $40,000. Potential assessment under the civil monetary penalties bill would be approximately $80,000. Second, an insurance company submitted inflated false financial statements required to obtain a license to do business, resulting in government approval of the license application. The potential assessment under the civil monetary penalties bill would be approximately $40,000.

Department of Housing and Urban Development

- The cases at HUD that could best benefit from the proposed legislation would be diversion of funds from multifamily projects in violation of 12 U.S.C. 1715z-4, and rental assistance and single family HUD/FHA insured loan fraud cases. Penalties and assessments which could be proposed through this legislation, if enacted, could be substantial.

General Services Administration

- GSA has developed a special computer program to identify cases that would be potential candidates for action under the proposed civil money penalties authority. The chart below depicts the number of GSA OIG cases against business enterprises for which civil and criminal action was declined by the

Department of Justice. Duplication of cases has been eliminated, as have cases with identified losses in excess of $100,000.

1982	1983	1984	1985 (to 4/30)
25	22	40	13

Individual case examples from GSA follow. There are other sample cases available should the Committee wish to review them.

- Investigation disclosed 28 instances of false billings by a GSA auto repair contractor during an 18 month period with a total estimate loss to the Government of $1,042. A United States Attorney declined prosecution, because of the low dollar amount. GSA subsequently settled with the contractor for $215. As five false invoices were involved, penalties of $50,000, and an assessment of $2,084, for a total of $52,084, could have been proposed, if the program fraud bill were law.

- In connection with a courtroom renovation contract, a judge requested walnut, as opposed to birchwood, cabinets. An investigation disclosed that the prime contractor submitted a change order which was inflated by approximately $15,000. In an interview, the subcontractor who did the work, indicated that the prime had subsequently increased its estimate for a change order by misquoting the figures submitted by him. Prosecution was declined. Since only one false claim was involved, the penalty under the program fraud bill would be $2,000, and the assessment, $30,000, for a total possible recovery of $34,000.

Department of Labor

o In Philadelphia, a physician was indicted on 5 counts of filing false claims and 13 counts of mail fraud. A two-year investigation by the Labor OIG and Postal Inspection Service found that he had verified and treated disabling, work-related injuries for several postal employees, including undercover agents who were not sick but claimed they wanted time off for vacations and other reasons. The doctor had instructed his patients on how to fake injuries and how to prevent their supervisors from catching them. The doctor was sentenced to four years probation, fined $7,500 and ordered to pay $900 in restitution. He was the certifying physician on 129 disability claims, many of them fraudulent, filed by USPS employees. Under the proposed civil penalty authority, the government could have followed this criminal prosecution with administrative proceedings to recoup its losses due to this fraudulent scheme.

Environmental Protection Agency

- In one case, the EPA discovered that a local agency deliberately submitted false claims to EPA. The Department of Justice was unwilling to pursue the case on either a civil or criminal basis, leaving no penalty for such wrongdoing. The proposed legislation would allow the Federal government to take action in cases such as this, where no judicial relief is available.

Small Business Administration

- At SBA, civil monetary penalties authority could be extremely useful in combatting fraud against the Small Business Set-Aside program, wherein large companies fraudulently certify themselves as small in order to receive awards. Such cases are difficult to prosecute because loss to the government often cannot be substantiated. In addition, the civil penalties authority could be used to penalize and deter frauds against the Small Business Investment Corporation program.

Department of Education

- The greatest benefit of having civil penalty authority would be realized in the Education Department student assistance program. While requirements that all administrative subpoenas must be "reasonable," and will only spawn needless litigation. Current IG subpoena authority contains no such limitation. Thus, an Inspector General who issues a subpoena for information that is relevant to a number of possible proceedings (e.g., civil monetary penalties, termination of benefits, recovery of overpayments, etc.), may be in the position of needlessly arguing under which subpoena authority he or she proceeded to obtain documents. We therefore suggest that this language be stricken and that the test of reasonableness remain implicit.

In conclusion, we strongly urge this Committee to act favorably and expeditiously on S. 1134. At a time of great concern over high budget deficits, we owe it to the taxpayers and the beneficiaries of our federal programs to do whatever we can to make certain that every federal dollar is properly spent. We believe S. 1134 is one sure means of moving us toward that objective.

thousands of post secondary schools and millions of students participate in these loan guarantee and grant programs, and while student aid appropriations account for approximately half of the Department's annual budget, dollar amounts for individual fraud cases are relatively small. These "small dollar" cases are often declined for prosecution by the Department of Justice, and in rare instances where prosecution is pursued, related costs far outweigh benefits. Audit and investigative experiences indicate that significant amounts have been obtained fraudulently under these programs. Given the alternative to adjudicate these offenses administratively, the Department could not only recoup lost funds, but could reduce instances of fraud, merely by publicizing the Department's authority to impose administrative assessments and penalties.

Department of Health and Human Services

- Current Civil Monetary Penalties authority at HHS extends only to the Medicare, Medicaid and Maternal and Child Health Programs. The proposed bill would extend this authority to all other programs administered by the Department, among them, Social Security, Public Health, Food and Drug and many

> others. The proposed authority would prove valuable in recovering from certain beneficiaries under entitlement programs. For example, we are currently investigating a physician who has been collecting disability insurance under Social Security for a number of years. Investigation has revealed that this physician billed Medicare and Medicaid in excess of $70,000 in one year while he claimed to be disabled. Should the Department of Justice ultimately decline prosecution in this case, it would be appropriate for civil monetary penalties under the proposed legislation.

We believe that the above case examples, as well as those presented by Mr. Sherick, the Inspector General for the Department of Defense in his testimony today, amply demonstrate the need for a civil penalty authority.

Certain provisions of S. 1134 of particular significance to the Inspectors General merit some comment here. First, many IGs are concerned about the provision of section 809(a) that requires each investigating official to prepare and submit to the agency head an annual report that summarizes (1) matters referred to the reviewing official, (2) matters transmitted to the Attorney General, (3) all hearings conducted, and (4) actions taken. Given the distribution of responsibility under the Act, the investigating official can easily provide current, accurate information only with respect to the first item. The remaining three matters concern actions over which the Inspectors General have no control (e.g., hearings and collection activities.) Therefore, we recommend that this provision be modified to transfer reporting responsibility to the appropriate officials. And, should the IG's retain reporting responsibility for "matters referred to the reviewing official," we suggest that this information be included in the Semi-Annual Reports of the Inspectors General.

The Inspectors General are also concerned about the inclusion in section 803(a)(2) of a "probable cause" standard for referrals by the reviewing official to the hearing examiner. Because "probable cause" is a term of art used most often in the context of criminal law, we believe that it may cause some confusion in this civil penalties bill. Therefore, in order to avoid any confusion over the use of the term, we strongly recommend that the Committee include a definition of this standard in its Committee Report.

Finally, in section 804(a)(2) the subpoena duces tecum authority granted to the investigating official has been modified to cover only documentary evidence "not otherwise readily available to the authority." We believe that such limiting language adds nothing to the existing

APPENDIX

The attached statement was drafted by the Legislation Committee of the President's Council on Integrity and Efficiency, based on comments received from the following Inspectors General:

Honorable Paul Adams
Department of Housing and
Urban Development

Honorable Herbert Beckington
Agency for International Development

Honorable Robert W. Beuley (Acting)
Department of the Interior

Honorable Bill Colvin
National Aeronautics and Space
Administration

Honorable Sherman Funk
Department of Commerce

Honorable Charles R. Gillum
General Services Administration

Honorable John Graziano
Department of Agriculture

Honorable William C. Harrop
Department of State

Honorable J. Brian Hyland
Department of Labor

Honorable Richard P. Kusserow
Department of Health and
Human Services

Honorable John C. Martin
Environmental Protection Agency

Honorable James R. Richards
Department of Energy

Honorable Frank S. Sato
Veterans Administration

Appendix - page 2

Honorable Joseph Sherick
Department of Defense
(See separate testimony)

Honorable James B. Thomas
Department of Education

Honorable Joseph P. Welsch
Department of Transportation

Honorable Mary F. Wieseman
Small Business Administration

STATEMENT ON S.1134
BY
SHERMAN M. FUNK
INSPECTOR GENERAL
U.S. DEPARTMENT OF COMMERCE
AT THE REQUEST OF
THE COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
MAY 23, 1985

It is my pleasure to submit this statement about S.1134, the "Program Fraud Civil Penalties Act of 1985." I appreciate the Committee's interest in hearing from the Inspector General community and hope that my comments are helpful in your deliberations. As you know, I testified before the full Committee in April 1982 to express my strong support for a program fraud civil penalties bill. In my four years as an Inspector General, I have always supported attempts to establish an alternative remedy for supplementing the Government's existing judicial remedies against perpetrators of fraud. I hope that this year the Congress will favorably act on S.1134. If enacted, this bill would help the Inspectors General to accomplish our task of preventing and detecting fraud in our respective agencies and, in the process, further bolster the integrity of Government programs.

We all understand the need for administrative sanctions in such agencies as the Departments of Defense and Health and Human Services, where the complexity and volume of the procurement and benefit programs make them vulnerable to fraud. The success of HHS's two-year experience with an administrative money penalty statute bears this out. But, even agencies with relatively small procurement and financial assistance programs, such as the Department of Commerce, can benefit from civil penalties authority.

All agencies which have been victimized by false submissions need an administrative mechanism for imposing monetary sanctions on the wrongdoers. The sanctions will act as both a deterrent to others and a means of recovering funds defrauded from the Government and its recipients. The current reliance on judicially-imposed remedies creates a number of problems:

o First, waiting for criminal prosecution usually means delaying administrative action. The all-too-frequent impact of this can be inordinate delays in recovering fraudulent expenditures or in punishing employees who are guilty of misconduct. Such an impact is exacerbated by the light penalties which courts often award white collar criminals; citizens perceive the end product of fraud to be a slap on the wrist. Fair and swift administrative penalties and monetary assessments to make the Government whole would be more meaningful justice in many cases, and would hit the wrongdoer in his pocketbook, where it hurts.

o Another problem is that, if the Department of Justice eventually declines criminal prosecution or civil action, the Department often is left after a long delay without an adequate or appropriate remedy against those who have corrupted its programs.

o Third, we must remember that the types of cases which this bill addresses are the small dollar false claims and the false statement cases, which are often economically unfeasible to pursue through the courts. Not only are these cases usually declined and often not pursued civilly, but they would become a burden on the court system if they were routinely accepted for action by Justice. Administrative action is the only way to assure that the Government has a meaningful remedy in these cases.

S.1134 would fill the gap in punishing those who wrong the Government and helping to recover misspent funds. Administrative action on these small cases will be expeditious and relatively inexpensive compared to litigation.

I have some other general comments about specific provisions of the bill:

o I am pleased that S.1134 explicitly covers false statements as well as false claims. Often, a false statement with no monetary loss can damage the government (in terms of decreased public integrity) as severely as monetary losses caused by false claims. I also endorse the bill's coverage of false submissions to Government recipients and other intermediaries. The same reasons for penalizing false submissions to the Federal Government apply when those submissions are made to a federally-funded entity or agent; indeed, this is where big item fraud often occurs.

o I applaud the addition of specific due process procedures in Section 803 of the bill. Just because this will be an administrative process does not mean that we should ignore the fundamental tenets of fairness that ensure due process of law for all citizens.

o The knowledge standard in Section 802(a) of the bill is another due process protection for contractors, recipients and other persons who deal with the Government. The requirement that the party have knowledge of the falsity of the claim or statement will prevent those with honest disputes with an agency from being charged. No one will be subjected to a sanction if negligence or lack of information led to the submission of a false claim or statement. Our efforts will be directed at those who know or have reason to know that their submission is false.

o I also support Section 802(b), which allows (but does not require) agencies to commence any lawful administrative or contractual action in addition to the civil penalties procedure. Debarment or suspension actions would be the most logical parallel actions. This additional, concurrent remedy represents another aspect of protecting the interests of the Government from a person who may have committed fraud. This does not stack the deck against any contractor because a party would still have the opportunity to present full arguments to the Government contesting the debarment or suspension proposal.

o Finally, under Section 803(a) of S.1134, it would be the responsibility of the Inspectors General to establish probable cause, building the government's complete case for an administrative hearing. In furtherance of their investigations, the Inspectors General would have the authority to issue testimonial subpoenas after notifying the Attorney General. Although we always hope for cooperative witnesses, experience teaches us that in many investigations there is no way to ensure their cooperation short of compulsory process. Testimonial subpoenas are therefore essential if we are to accomplish the goals of S.1134. I assure this Committee that I, as IG at Commerce, will exercise this authority in close consultation with the Department of Justice. This will protect the rights of the accused, ensure that applicable Government-wide standards are followed consistently, and help prevent interference with possible criminal prosecution.

I would like to offer a few illustrations of how the Department of Commerce can use administrative penalties to the advantage of the Government.

o We have a pending case with a U.S. Attorney's Office, which is about to issue a decision not to prosecute. A recipient was given a $150,000 grant for a project. Our audit/investigation revealed that over $70,000 of grant funds were fraudulently diverted. The case lacks prosecutive merit, not because of the dollar amount, but because the grantor agency was lax in enforcing the provisions of the grant. However, the grantee knew or should have known that certain expenditures were not legal. Not only could we pursue the case for the false claims aspect, but the grantee misrepresented facts to the Department in the original application which materially induced the grantor agency to award the grant.

o The next example is one of a series of cases which are never prosecuted but which could be handled under civil penalties authority. Our audits have disclosed that in one Commerce program, some recipients are reporting inflated, or overstated, project achievements in order to induce the grantor agency to renew their cooperative agreements. There is no monetary loss to the Government because the grant is for a minimum level of effort, which is met. However, the integrity of the entire process has been called into question by these false statements. Actions against these recipients under civil penalty authority would act as a powerful deterrent to others who would seek to mislead the Government.

o In addition, in Commerce, we have had a variety of employee fraud cases that could benefit from civil penalties authority, especially in view of the reluctance of many managers to take strong disciplinary actions against employees who have acted improperly. For example, an extensive overseas investigation yielded evidence of serious misconduct by a Foreign Commercial Service official. The evidence showed that the employee had (1) taken kickbacks from temporary employees; (2) submitted fraudulent vouchers to his agency; (3) deliberately overbilled a state government for services and pocketed the excess funds; (4) used government money for private purposes not connected with official activities; and (5) submitted a falsified bank document to the agency in an unsuccessful attempt to discredit some of our investigative findings. The improperly diverted funds amounted to about $6,000, and prosecution was declined. The official finally resigned from the FCS, but only after the Department had delayed many months in taking action on our recommendation to remove him.

I have only one suggestion for improving S.1134. Section 806(g) provides that all amounts collected shall be deposited as miscellaneous receipts in the Treasury. I believe that agencies would pursue civil penalty cases more aggressively if they could recoup at least some of the money that is collected. After all, one of the purposes of the bill is to "recompense . . . agencies" for losses resulting from false claims and false statements. Depositing assessments in the Treasury provides restitution to the Government (taxpayers) as a whole, but not to the agency whose funds were misused.

In conclusion, let me restate my strong endorsement of this bill, which promises to significantly enhance the Government's efforts to fight fraud.

For the record, this statement represents my personal opinion as an Inspector General and does not necessarily represent the views of the Administration on specific aspects of S.1134.

* * *

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

MAY 21 1985

THE INSPECTOR GENERAL

Honorable William V. Roth, Jr.
Chairman
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

We strongly endorse S. 1134, the Program Fraud and Civil Penalties Act of 1985. This bill which creates an administrative process for imposing monetary penalties for fraud against agencies is desperately needed.

The bill is vital for Federal Agencies to more aggressively and effectively pursue fraud in Government programs. Currently, in instances where the amount of loss to the United States is relatively small, or the case lacks prosecutive merit for other reasons, the administrative action available to executive agencies is often limited to debarment or suspension from Federal programs. This sanction, though important, does not provide the government an opportunity to recoup its losses.

Too many times cases are too small or do not have sufficient jury appeal for the Department of Justice (DOJ). For example, we have reason to believe a local governmental agency submitted false claims to the Environmental Protection Agency. Since DOJ has been reluctant to pursue this case on either a criminal or civil basis, the Agency had no penalty available for the wrongdoing.

The bill will allow agencies to take appropriate administrative action when judicial relief is not available. By providing civil penalties, the bill will also be a deterrent to those contemplating fraud against the government.

We welcome the additional tools, provided by this bill, that serve to deter fraud and help recover Federal funds lost due to fraud. Should your staff have any questions, please have them contact Roscoe R. Davis, Assistant Inspector General for Management and Technical Assessment, on 382-4912.

Sincerely,

John C. Martin

John C. Martin

STATEMENT OF THE
NATIONAL SECURITY INDUSTRIAL ASSOCIATION
ON
S. 1134, THE PROGRAM FRAUD CIVIL REMEDIES ACT OF 1985
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT
OF THE
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

JUNE 18, 1985

REVISED AUGUST 16, 1985

The National Security Industrial Association is pleased to have the opportunity to submit a statement on S. 1134, The Program Fraud Civil Remedies Act of 1985. We thank the Committee for requesting our comments, and we hope that our thoughts will assist the Committee in its deliberations.

The National Security Industrial Association (NSIA) is a national organization of more than 385 manufacturing, research, legal and educational organizations of all sizes and from all segments of industry interested in and related to the nation's security. NSIA is a not-for profit, non-political, non-lobbying association established in 1944 to foster a close working relationship and effective forum for communication between government -- primarily those entities involved in national defense -- and the industry which supports it. A copy of our annual report, which includes a list of our members, is attached.

The proposed bill is designed to enhance the government's already extensive arsenal for combatting procurement fraud. The bill provides the government with increased investigatory rights and the ability to impose significant additional punishment on contractors, while at the same time reducing the traditional safeguards afforded the accused that are designed to ensure fairness in our judicial system.

Our association appreciates the goal of S. 1134 -- providing an economical remedy for the small fraud case. We further share the Committee's general concern over the need to resolve procurement fraud problems and deter false claims. However, we note that existing laws and recent congressional initiatives already are having a major impact in bringing abuses to the surface and permitting their correction. Remedies presently available include the False Claims Act, the False Statements Act, the Truth in Negotiations Act, and dozens of other statutes and regulations. Recent initiatives by Congress include the Contract Disputes Act, the Inspector General Act, the Competition in Contracting Act, and the greatly increased numbers of competition advocates, investigators and auditors.

Accordingly, in our view, S. 1134 is not necessary to provide the government with an additional remedy to be applied in situations already covered by existing laws and regulations.

Further, we believe that before the bill can be supported, changes are required in five (5) areas.[1]

Summary

We believe S. 1134 possibly would have a legitimate purpose if it were directed primarily at the small fraud situation -- from welfare claims to contract claims -- which would not be prosecuted by the Department of Justice or the U.S. Attorneys for cost-benefit reasons. The scope of S. 1134 should be limited to include only such situations.

Charging an individual or company with fraud is a very serious measure. Trial and conviction are even more serious. Traditionally, Americans have had a right to a trial by jury in these cases. Removing this right to a trial in the judicial system is a step fraught with danger and raises multiple possibilities of using the government's resources to harass or destroy a citizen or his company.[2] Therefore, each aspect of coverage of S. 1134 should be considered very carefully.

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[1] These comments originally were drafted prior to the Subcommittee's revision of S. 1134. However, we do not believe the changes in the Subcommittee's August 1, 1985 revision of the bill fully address our concerns. The remaining inadequacies in the revised bill are addressed in the ensuing footnotes. (The only changes to the original text are on the section on debarment and suspension on pages 6 and 7.)

We begin our analysis with two general comments. First, we recognize that some small fraud cases will not be prosecuted unless there is an administrative remedy. Second, S. 1134 contains important improvements over prior bills in the areas of due process and definitions of fraud. Nonetheless, the bill must be improved before it is added to the already awesome arsenal of the government's powers over its citizens.

We have specific comments in five areas where we believe changes are required: (1) the relationship between proceedings under S. 1134 and administrative debarment; (2) the need for more separation between program personnel and prosecution; (3) the unnecessarily large scope of the bill's coverage; (4) the excessive penalties and duplicate remedies; and (5) the provision for subpoenas to compel testimony. We stress that these constructive criticisms should not be construed as blanket opposition to the bill.

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[2] The Subcommittee's substitution of the word "remedies" for "penalties" throughout the bill does not alter the essentially punitive nature of the bill. This is evidenced by the fact that the administrative "remedy" under the bill for a small false claim is five times greater than the existing "penalty" the government may recover in a district court civil false claims action, regardless of the size of the claim. See 31 U.S.C. § 3729.

Relationship to Suspension and Debarment

We first discuss the relationship between proceedings under this legislation and the existing rules on suspension and debarment. The association is concerned that the mere initiation of proceedings under S. 1134 could lead to suspension or debarment of a contractor under existing procedures under the Federal Acquisition Regulation. Under these regulations, there would be no independent prosecutorial review or trial by jury, and a contractor could be suspended, government-wide, without a prior hearing upon the determination of one agency that a contractor should be prosecuted or that a contractor has committed fraud.

At the present time, as a result of recent amendments, the Department of Defense provides for an almost automatic debarment following a felony conviction. We believe that the present DOD FAR Supplement regulations on suspension and debarment incorrectly convert the debarment process to one which emphasizes additional penalties rather than one which focuses on present responsibility. Our association is willing to work with the Department of Defense to cure these errors in its regulations.

We recognize that Senator Cohen went to some length in his introductory statement to assure the Congress that no link is intended between administrative actions under this bill and suspension and debarment. Nevertheless, as the legislation presently is drafted, there exists the strong probability that a conviction under the proposed legislation would lead automatically to a one-year debarment. Moreover, a finding of probable cause or a decision to prosecute under the proposed legislation would automatically trigger initiation of suspension and debarment proceedings. In the present climate, more explicit language in the bill itself is required to assure that Senator Cohen's goal will be achieved.

This problem can be solved if the legislation is clarified so as to divorce the question of determining the liability for the false claim from the question of present integrity and responsibility. We recommend that Section 802(b)(2) be amended to permit the agencies to consider the final determinations made under the "small false claims" procedure in arriving at a consideration on whether to suspend or debar, and also to make clear that such determinations, i.e., a finding of liability, shall not be determinative of the issues of present responsibility. With these changes, determinations of liability under Section 802 could not be used as a conclusive determination regarding the contractor's present integrity and responsibility.3/

We believe that additional restrictions must be placed upon the use of a finding of "adequate evidence" by the reviewing

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3/ The revised S. 1134 accomodates this concern and appropriately provides that a finding of liability shall not be considered a conclusive determination of nonresponsibility for purposes of debarment and suspension proceedings.

official. The determination of "adequate evidence" may be made by an individual without legal training and without judicial supervision, and without any due process for the accused. Section 802(b) should be amended to make clear that a mere determination to proceed with a prosecution under the bill should not itself be permitted as evidence in any debarment or suspension proceeding. Instead, in a suspension or debarment proceeding initiated as the result of a mere determination to proceed with a prosecution under this bill, the agency would be required to introduce evidence of the contractor's alleged wrongdoing.[4]

With implementation of the above measures before suspension or debarment could be imposed by the agency, it would have to be required to conduct further proceedings to consider such factors as the actions underlying the determination under this bill, subsequent corrective measures, reorganization of the company, disciplinary actions, the lapse of time between the event and the conviction, and the contractor's recent reputation and performance record. Thus, the ultimate determination on the issue of suspension and debarment would be based on the contractor's actions and considerations of the contractor's present responsibility, as required by the pertinent regulations.

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[4] The proposed revisions to S. 1134 do not remedy this concern. The revised bill, when read in conjunction with the present suspension regulations, still permits an agency to suspend a contractor for an indefinite period of time based on a finding of "adequate evidence" under S. 1134 without a prior hearing by the agency on the underlying facts or on the issue of present responsibility.

Independent Decision to Prosecute

Our second area of concern is the lack of sufficient separation and isolation of the prosecutorial function from the program/procurement and the investigative functions. We recognize that the proposed legislation provides for a reviewing official who will decide whether the case presented by the investigators should be prosecuted. However, there is no guarantee that official will exercise independent judgment, and indeed, we must presume that any official located in the procuring agency or the agency responsible for the investigation cannot be independent. Under the proposed system, the agency responsible for the program (procurement, welfare distribution, etc.) is responsible for investigating a suspected false claim. It is probable that in many cases the agency will be responding to public pressures to find a wrongdoer to explain an embarrassing phenomenon. In other cases, program officials, including their supervisors and the assistant secretaries and secretaries of the departments, will find it convenient to begin an investigation, charge an individual or company with fraud, and initiate a trial in order to divert attention from what may be -- and often is -- a case of mismanagement or judgment errors by the agency. There is no way that any individual within the program agency can be expected to withstand in every case -- especially the more controversial cases -- the pressures to initiate and pursue the prosecution.[5]

Historically, Americans have been entitled to an independent review process. In fact, there are multiple ways the present system places a check and balance on the zealous investigator or the angry and embarrassed program agency. The most notable is the use of the Department of Justice, Criminal Division, Fraud Section, which reviews cases and determines whether they are "prosecutable." It would be in error for this committee to believe that most of the cases which the Department of Justice declines to bring are dropped because of the lack of resources to prosecute. An equally important reason for the Department of Justice decision not to prosecute is the independent determination of experienced criminal lawyers that the case does not have legal merit.

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[5] The revised bill only partially remedies this problem. It provides that the reviewing authority may not be in the organizational unit of the investigating official or supervised by the investigating official. However, the reviewing authority still may be an employee or official of the procuring and investigating agency, or of the organizational unit responsible for the program under which the alleged false claim or false statement arises. Thus, the reviewing official still may not be in a position to exercise independent judgment. Further, the bill still does not require the reviewing official to be a lawyer trained to determine what constitutes adequate evidence under the law.

U.S. Attorneys throughout the land perform a similar function. Accordingly, notwithstanding the pressures of the FBI or other investigating agent or the pressures of the executive agency which feels wronged, an independent, experienced criminal trial lawyer decides whether the case should be prosecuted. The judicial system also contains a second check and balance. Before the prosecution goes forward, there must either be an indictment from a grand jury or an information followed by a determination of a U.S. magistrate that probable cause exists. Thus, there are two important hurdles in the present criminal judicial system where a responsible and trained individual, completely independent from the investigators or the program managers, decides whether to go forward with prosecution.

The present legislation would substitute for both of these historic and meaningful restraints a reviewing official within the program agency. That simply is inadequate. Moreover, it is dangerous. We urge the committee to place this reviewing authority in the Department of Justice. (We recognize that the present legislation calls for a period of review by the Department of Justice, but that review is limited to the decision of whether the Department of Justice will take over the case.) Moreover, it would even be preferable to transfer the entire responsibility for making the decision to prosecute and prosecuting to the Department of Justice.

We believe the Committee should recognize that this legislation will require the hiring of prosecuting attorneys. Is it better to empower each agency to hire additional lawyers, perhaps not well trained in criminal prosecutions, to carry out these functions, or to leave them in the hands of the well-trained lawyers of the Department of Justice? Why should Congress provide for duplicate prosecuting functions in each of more than a dozen departments and agencies thereby incurring significant cost inefficiencies and placing responsibility for implementing this bill on numerous inexperienced and untrained lawyers? The association believes it would be more cost effective and more professional to provide that the prosecution functions be placed in the Department of Justice. Since more attorneys must be hired to pursue these cases in any event -- existing resources will not meet the needs of trying these newly created causes of action -- why is it not better to hire fewer and more professional attorneys in the Department of Justice? We hasten to add that this will not obviate the gains sought by the Committee. The streamlined administrative process under the bill still would provide a less costly and time consuming process than now exists under the criminal justice system.

If the Committee chooses not to accept our suggestion that the entire prosecuting function be shifted to the Department of Justice, we urge that at the very least, the legislation be changed to require that all proposed prosecutions be forwarded to the Department of Justice for a determination on whether the case should be prosecuted in any forum. This places the very necessary check and balance in the system which we have previously described.

Unnecessarily Large Scope

Our third concern centers on what we believe is the unnecessarily large scope of the coverage of S. 1134. This comment has three subparts. First, we urge the Committee to consider lowering the ceiling on false claims covered by this act from $100,000 to $50,000. We reiterate our understanding that the basic premise of this bill is to provide an administrative forum only for those cases where it is not economical to pursue the matter under the normal criminal judicial process. If we are truly concerned about implementing this new and problematical administrative remedy only for small fraud cases, our association believes that a $50,000 limit is appropriate. We believe U.S. Attorneys throughout the land are not loathe to prosecute fraud claims in excess of $50,000, currently prosecute such cases, and have the resources to do so. If this belief is correct, prosecution of such cases should be left in the normal criminal judicial arena.

A second subpart of our concern over breadth of coverage is the ambiguity in the application of this ceiling. Regardless of whether the ceiling is $100,000 or $50,000, the bill should make it very clear that claims, invoices, etc. cannot be separated so as to create a series of actions which fall under the jurisdictional limit. We recommend that you modify Section 803(c) to require that all claims related by one set of facts (contract, persons, scheme) be considered as one claim for the purpose of determining whether the claim falls under the jurisdictional limit. Without this change, it is likely that agency investigators and prosecutors will be tempted to split causes of action in order to utilize this new remedy.[6]

Our third thought in this area involves the propriety of including false statements. We understand the Committee's purpose to be the development of a streamlined administrative remedy designed to recoup for the government its losses due to false claims. Recovery of damages and modest penalties to compensate the government for its effort is a logical remedy and an understandable goal. However, in the case of false statements, there is no tangible damage, and it might appear that this legislation is designed more as a penalty rather than as an attempt to recoup damages. In this area, the bill appears more to be purely a criminal statute designed to punish. In our opinion, accomplishing that goal should be left to the criminal justice system.[7]

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[6] Once again, the revised bill does not entirely alleviate this concern. For example, under the revised language, 10 related claims (or invoices), each of which is for $99,000 and is allegedly "false" due to one act or scheme, would come within the jurisdiction of S. 1134 if the claims were not submitted simultaneously. Thus, this legislation would reach far more than "small" claims, and whether a particular group of claims would come within the ambit of S. 1134 would not be based on any rational basis, but rather on sheer happenstance.

Excessive Penalties

The fourth area of concern for our association is the huge exposure for damages and penalties. We are not sure that this result was intended by the Committee, and we believe that the problems can be solved easily. Again, we divide this area of concern into several subparts. First, Section 802(a)(1) appears to provide for the assessment of damages in an amount twice the total amount of the claim submitted, even if only a portion of the claim is improper. This section should be clarified to provide that the assessment is limited to twice the amount of the damages suffered by the United States. Presently, the legislation permits jurisdiction to be assumed where there is an

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7/ An additional problem regarding the scope of the bill is the expanded definition of what constitutes a false claim. Under S. 1134, a request to a non-federal entity for money, property or services could result in liability if the United States provided the non-federal entity with any portion of the funds provided to the claimant or used to purchase the property or services provided the claimant. However, the courts have held that only a claim "capable of causing an injury to funds or property of the United States" can violate the False Claims Act, regardless of whether the non-federal entity had originally received the funds from the United States. United States v. Azzarelli, 647 F.2d 757 (7th Cir. 1981). Thus, S. 1134 creates a bizarre situation in which the size of the claim (greater or less than $100,000) could be determinative of whether the claim violated a federal statute.

allegedly fraudulent claim in an amount less than $100,000. However, the total amount of the claim may be far greater. Permitting damages "twice the amount of such claim" could permit this new and untested administrative forum to assess inappropriate, extraordinary and catastrophic damages.[8/]

Second, Section 802(a)(2) permits the imposition of penalties and assessments for false statements. As indicated before, we believe that this portion of the bill should be dropped because a penalty for a false statement is punitive rather than remedial. However, if the section is retained, the provision providing for damages (in addition to the civil penalty of not more than $10,000 for each statement) should be dropped. By permitting penalties and assessment of damages for false statements unrelated to any claim or loss by the government, S. 1134 becomes a criminal penalty statute which requires even greater due process rights than afforded under the bill.

Subpoena to Compel Testimony

The legislation provides in Section 804(a) that the investigators may subpoena witnesses and compel the attendance and testimony of such witnesses during the course of an

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8/ The revised S. 1134 attempts to limit the government's recovery to twice the amount of the damages it sustained, but still is somewhat ambiguous. This provision could be clarified by amending Section 802(a)(1)(C), lines 11-14, to read as follows: ". . . of not more than twice the amount of the portion of such claim which is determined . . . ."

investigation. This is an extraordinary provision which has heretofore been denied to representatives of the Executive Branch. Not even F.B.I. agents -- whose training is more extensive than that of trained I.G. investigators -- are given this subpoena power. At this time, only grand juries can compel testimony during an investigation. It would be an extraordinary and unnecessary step to permit hundreds of investigators to subpoena companies and individual citizens and compel testimony during the course of an investigation. We urge the committee to reject this drastic change in our procedure.[9/]

Closing Statement

In summary of our position, NSIA recognizes and appreciates the Committee's concern about program fraud. We also appreciate the apparent need for an economical, administrative remedy where

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[9/] The Subcommittee's attempt to circumscribe the subpoena authority does not alter our staunch opposition to this ominous provision. The approval for issuance of a subpoena under the revised bill will ultimately become a "rubber stamp" process, and subpoenas will be issued at the request of, and enforced by, the lowest level investigators. Not only is this a vast expansion of the government's existing investigatory authority (and delegated to an inappropriate group), but it also creates the anomalous situation in which the extent of the government's rights is determined by the size of the alleged false claim and the forum in which it is being prosecuted; an I.G. investigator investigating an alleged violation of this bill could issue a subpoena, but the same investigator conducting a criminal investigation of the same incident or an investigation of a "large false claim" could not issue a subpoena compelling testimony. Clearly, this subpoena power will be subject to great abuse.

instances of small fraud have damaged the United States. However, we believe that the best manner for addressing these concerns is through increased enforcement of the numerous existing laws and regulations by well-trained and qualified Department of Justice personnel. Creating within program agencies -- including those administering welfare payments, student loans, grants, and procurement -- a mechanism for investigating, prosecuting and convicting citizens of fraud is inherently dangerous. The founding fathers were concerned about the dangers of a powerful and intrusive central government. In this decade, we are still concerned about "big government" "getting off the backs" of its citizens. Nothing could be more ominous in the sense of George Orwell's 1984 than one or two dozen fraud investigator/prosecutor/judge units distributed throughout the federal government. We recognize that this bill contains important safeguards not present in earlier bills. However, additional safeguards and restrictions are required, and we urge the Committee to proceed with extreme caution in this area. We conclude this statement by thanking you again for the opportunity to present the views of this association.

Shipbuilders
Council of America
1110 Vermont Avenue, N.W. ■ Washington, D.C. 20005 ■ (202) 775-9060

Statement
of
Jed L. Babbin
Vice President and General Counsel
Shipbuilders Council of America

Before the
Subcommittee on Oversight of Government Management
Committee on Governmental Affairs
United States Senate

Regarding
The "Program Fraud Civil Penalties Act of 1985"
S-1134

June 18, 1985

Mr. Chairman and members of the Subcommittee, I am Jed L. Babbin, Vice President and General Counsel of the Shipbuilders Council of America which represents the principal domestic shipbuilders, ship repairers and suppliers of equipment and services to those industries. A copy of our membership list is attached to this statement. I request that my entire statement be included in the record.

We applaud the Subcommittee's efforts to deal with the complicated and frustrating problem of fraud against government agencies. Until the introduction of this legislation, there appeared to be no way to deal with the small fraud cases which U.S. attorneys are reluctant to prosecute.

Earlier in my career, I had the good fortune to serve as an advisor to the Air Force Office of Special Investigations in the area of government contract fraud, and as a lecturer on that subject at the A.F.O.S.I. school while assigned to the staff of the Judge Advocate General. I was frequently frustrated by procurement officials' reluctance to deal with the problem and by prosecutors' lack of interest in pursuing the usually small yet complex government procurement cases. Since then, with the advent of the Department of Justice's Defense Procurement Fraud Unit and similar task forces established to deal with nondefense industries, there is reason to be confident that the problem is being handled thoroughly and competently.

S-1134 attempts to deal with the broad problem of government contract fraud by removing the government's remedies from the courts and placing them in an administrative setting. In doing so, we believe it will have a confusing and disruptive effect on the entire government procurement process. It drastically alters the definition of fraud for everyone dealing with the government and so confuses remedies open to both the government and the contractors as to make many of them unworkable.

While we agree that there is a need to deal with certain cases of fraud under an administrative remedy, we are thus still compelled to oppose S-1134 in its present form.

THE CONCEPT OF FRAUD SHOULD NOT BE DEFINED AWAY TO INCLUDE UNINTENTIONAL ACTS

Under common law, there are five elements which must be present in either civil or criminal fraud: (i) a false representation material to the transaction; (ii) which is known to be false; (iii) made with intent to defraud; (iv) which is relied upon by the victim; (v) to his injury. In the case of fraud against the federal government, the mere presentation of a false claim to the government is sufficient; the government need not rely on it or be injured in order to have a punishable fraud. The definition of a false claim under S-1134 confuses the element of intent. It cannot logically be stated that a fraud has been committed where that element is not clearly required.

Intent: Are Honest Mistakes to be Punished as Fraud?

In defining both false statements and false claims, section 802 refers to representations which the person "knows or has reason to know" is false. While the "knows" provision approximates an intent requirement, the "has reason to know" language confuses the issue considerably. As we stated in respect to the predecessor to this bill, our principal concern is that unintentional acts, performed innocently, should not be stigmatized as fraud. The new provision is far better than the approach taken last year, but still causes us concern.

The courts' interpretations of the civil False Claims Act, 31 U.S.C. section 231, have varied widely on whether and how specific intent to defraud must be shown. However, the majority of the circuits follow the logic often cited by the Supreme Court in discussing other aspects of the False Claims Act: the criminal and civil False Claims Acts contain the same words and therefore must be given the same meaning. Thus, either clear intent or a pattern of affirmative conduct from which intent can be inferred, is required under the civil statute. The definition of the offense is the same, whether civil or criminal, and in either case intent must and should be involved. This is, we believe, the only appropriate standard to adjudge fraud by, and it should be adopted here.

There are many instances in government contracting where the government requests submission of cost and pricing data in a preliminary or incomplete form prior to the negotiation of contract awards or contract price adjustments. There are instances in which both the government and the offeror will know that a proposal contains errors in that it has not been updated, or that events have occurred which are not included, but it will be necessary and even desirable to submit it to the government in expediting a procurement. This is useful when it is known that the government is aware of the facts, when an updated proposal will be submitted later, and when errors are of the type that are within normal estimating margins of error.

Without specifically requiring that an intent to deceive be present, many innocent and good faith acts may be made punishable as fraud. This would conflict with logic, with the Contract Disputes Act (which specifically requires intent to deceive) and with the Truth in Negotiations Act, Public Law 87-653, which requires certification of completeness and accuracy of cost and pricing data. These acts, along with implementing regulations and contract clauses, recognize that facts and data do change and that so long as there is no intent to deceive, the proper remedy is a simple adjustment in contract price to correct the error.

AGENCY PROCEEDINGS AND LIMITED JUDICIAL REVIEW WILL PRECLUDE FUNDAMENTAL FAIRNESS

Since last year, drafters of the bill have made an effort to ensure fairness in the adjudication procedures established here. While these aspects of the bill are, once again, far better than the last version, they fall short of their objective of providing due process and fairness to the accused.

For example, procedures to permit discovery by the accused are left to the discretion of the hearing examiner. If fairness is to be ensured, discovery must be a right, not a privilege. Discovery can and should be limited to preclude dilatory exercises, but not otherwise.

Most contractual claims are based upon actions of the agency itself which change the contractor's cost of performance. Only the right of an individual to have these disputes resolved by a third party can provide the fairness and due process our Constitution guarantees. It is not by accident that our judicial system is built upon a system of checks and balances, one with independent investigators, prosecutors, judges and juries. The Congress has frequently recognized the potential abuses which may result from making one party to the dispute the trier of facts. For this reason, section 10 of the Contract Disputes Act of 1978 guaranteed the contractor the right to elect the courts as his forum in lieu of agency boards of contract appeal. Never before has anyone established such unilateral authority in an agency as this bill would provide.

The measure of the powers granted an agency under S-1134 is best shown by examining the penalty which may be assessed. Under section 802, the person filing a false claim or statement would be liable for a penalty of up to $10,000 for each claim or statement determined to be false plus either: (a) a fine equal to twice the amount of the claim; or (b) an assessment of the damages suffered by the agency.

Section 802 further provides that notwithstanding any other provision of the law, the penalties provided in this Act may be imposed in addition to those imposed under other laws. This apparently means that penalties under the False Claims Act, the Contract Disputes Act, and the Truth in Negotiations Act, may be applied cumulatively with this one. Without some assurance of proportionality between offense and punishment, this accumulation of penalties can create unjust results.

These extraordinary agency powers carry with them great potential for abuse. Even so, they could be controlled with prompt and complete judicial review. However, the judicial review of agency decisions is so circumscribed that they may be precluded from controlling abuse.

The agency's decision must, under section 802(g), be in writing and include "findings and determinations." Such decisions are not required to include specific findings of fact or conclusions of law. Thus, there is not even a guaranteed adequate record for judicial review.

Worse yet, the restrictions on judicial review render the findings of the agency conclusive if supported by "substantial evidence."

A contractor would then be faced with a situation where he would be attempting to overturn an agency decision, which is sketchy at best, on the basis that it was not supported by substantial evidence, rather than the "clear and convincing" evidence rule required under the False Claims Act.

In order for an administrative remedy of this type to work at all, an independent agency would have to be established to adjudicate the claims, a thorough record and complete decision required in each proceeding, and complete judicial review ensured.

AGENCY PROCEEDINGS SHOULD NOT BE SUBSTITUTED FOR VIGOROUS PROSECUTION OF FALSE CLAIMS

Section 803(c) of S-1134 sets forth the limitation on actions which may be brought administratively. In doing so, it gives agencies authority over cases which are well within the range of those normally chosen for prosecution by United States attorneys. Moreover, it places the cart before the horse in giving agencies first chance at prosecution unless the Department of Justice objects.

Section 803 provides that agencies may handle cases of claims or statements valued up to $100,000. This is far above the range which should be permitted. In my experience, I have seen that most federal attorneys will accept for prosecution cases which involve claims of $20,000 or more. We suggest that this is a more appropriate limitation on agency actions under S-1134. If the case involves claims of aggregated value of more than $20,000, and the Department of Justice determines there are inadequate grounds for prosecution, the government can only reasonably assume that there is insufficient evidence or some other compelling reason to decline prosecution. No agency should be permitted to pursue cases in which such a determination has already been made.

Under section 806, the agency has the "first cut" at pursuing a false claim case. It should be precisely the other way around. In all cases, regardless of value, an agency should be required to present its evidence to the Attorney General, or the local United States attorney, to seek action in federal court under the civil and criminal False Claims Acts. Only in cases where prosecutorial discretion leads to the decision not to seek an indictment or bring a civil action should the agency be permitted to pursue the claim administratively and then only when it is valued at $20,000 or less. Further, the agency should be able to pursue only those cases where prosecution is not undertaken because the claim is too small. Cases valued at under $20,000 will frequently be judged not worthy of prosecution and are best pursued administratively. To give the agencies first choice in prosecuting false claims is to provide a strong disincentive to pursuit of stronger remedies in court.

CONCLUSION

We believe that S-1134 represents a serious attempt to deal with a serious problem. The issue of fraud against the government is not one which should be treated lightly. Nevertheless, our zeal in pursuing this problem should not be so great as to create larger problems then we solve.

ATTACHMENT

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July 11, 1985

The Honorable William S. Cohen
Chairman, Subcommittee on Oversight
of Government Management
Committee on Governmental Affairs
United States Senate
322 Hart Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The Proposed "Program Fraud Civil Penalties Act of 1985"

In connection with the Subcommittee's hearing on June 18, 1985 on S. 1134, the proposed "Program Fraud Civil Penalties Act of 1985," which you introduced on May 15, 1985, we present the views of the Machinery and Allied Products Institute (MAPI). It is requested that our statement be entered in the formal record of the hearing.

MAPI represents the capital goods and allied products industries of the United States. In addition to traditional capital goods product lines, MAPI's constituency includes leading companies in the electronics, precision instruments, telecommunications, computer, office systems, aerospace, and similar high-technology industries. Although many of the companies in these industries are predominantly oriented towards the commercial market, many have substantial defense sales and, accordingly, have a particular interest in government contracts and in any proposed legislation, such as S. 1134, which might adversely affect contractors in their relationship with the government.

S. 1134 would provide departments and executive agencies with an administrative remedy for handling false, fictitious, or fraudulent claims and statements under $100,000 that the Justice Department has declined to prosecute.

We note that S. 1134 is an improvement over the two earlier bills on the same subject that were introduced by Senator William V. Roth, Jr.--S. 1566 in the 98th Congress and S. 1780 in the 97th Congress. The latest redrafting of the "Program Fraud Civil Penalties Act," as represented by S. 1134, has resulted in the clarification of several issues as well as partial strengthening of due process rights for respondents.

Notwithstanding the improvements in S. 1134 over its predecessor bills, we are opposed to the bill for fundamental reasons. Following a summary of the MAPI position, we set forth in detail our reasons for our opposition and our comments on specific provisions of the bill. While we believe fraud should be appropriately penalized, we urge that this legislative proposal does not represent the best approach to that problem.

The MAPI Position in Brief

We oppose adoption of S. 1134 because we believe that allegations of fraud call for judicial, not administrative, determination. The bill represents a dangerous abrogation of the fundamental principle that serious penalties should be imposed on persons only through judicial proceedings. Although the bill admittedly makes some provision for observance of due process, we do not think that it would adequately protect the rights of the accused as to discovery rights, certain unsatisfactory procedures, and subpoena authority.

As for saving money, neither logic nor experience suggest that administrative procedures are inherently more cost-effective than judicial. Beyond that, there are real opportunities for cost savings in the present judicial system whereunder, to repeat, fraud proceedings should remain. Further, cost should not be the basis for stripping persons of due process rights.

These central arguments against S. 1134 are elaborated more fully at a later point in this statement.

If, despite our basic recommendation to the contrary, the Subcommittee desires to proceed with this bill, it should, at a minimum, amend the bill in accordance with the following:

1. To ensure independence and impartiality, the hearing examiners should be selected and appointed as full-time administrative law judges.

2. The reviewing official should also be independent; the Department of Justice should perform the tasks of the reviewing official for all government agencies.

3. Respondents should retain the right to subpoena witnesses to testify during the hearing, and should retain the right to at least limited pre-hearing discovery.

4. The bill should be clarified to indicate that the government may not proceed against a single false claim in both judicial

and administrative proceedings and thereby collect treble or quadruple damages.

5. The scope of the double-damages provision should be clarified to indicate that it applies to the fraudulent portion of a claim, not the entire claim.

6. Claims relating to similar facts or circumstances should be aggregated for the purpose of applying penalties and the $100,000 jurisdictional limit.

7. The $100,000 jurisdictional limit should apply to not only the amount fraudulently claimed, but also the amount of the penalties that may be assessed.

8. Investigating officials under the bill (in most cases, including the Department of Defense (DOD), these would be Inspectors General) should not have the power to subpoena testimony.

9. The bill should be clarified to indicate that a finding of liability under the bill could be considered, but would not be determinative, in a debarment or suspension hearing as to whether an individual or company should be debarred or suspended.

10. The term "reason to know" should be defined in the bill and should include no more than "deliberate ignorance" and "recklessness," and certainly not gross or lesser forms of negligence with respect to the respondent's knowledge.

Administrative Versus Judicial Proceedings

In our view, the bill represents a dangerous abrogation of the fundamental principle that serious penalties should be imposed on persons, whether corporations or individuals, only through judicial proceedings. The validity of the principle is not diminished because it may be expensive or difficult to provide for such proceedings.

We recognize that the bill provides for judicial review of a determination of liability and that certain elements of due process would be afforded respondents. With respect to due process rights, the bill requires an agency to conduct administrative proceedings pursuant to either the procedures in the Administrative Procedure Act or similar procedures in agency regulations that would be promulgated pursuant to guidance in the bill.

The Due Process Issue

We do not believe that the due process procedures of the bill would be adequate to protect the interests of respondents. To illustrate, the bill provides:

1. Inadequate discovery rights for respondents;
2. Unsatisfactory procedures with respect to independence, fairness, and qualification of both hearing examiners and reviewing officials; and
3. No right for respondents to subpoena witnesses on their behalf during the hearing.

In sum, we firmly believe that an administrative remedy as envisioned by the bill would not provide fundamental due process to respondents. Accordingly, we believe that small fraud claims should be prosecuted in the judicial system, but we recognize that the judicial system should be changed to make the prosecution of such claims faster and more cost-effective.

Administrative Remedy May Be Costly

The basic impetus for the bill's administrative remedy is the belief that it is not cost-effective to prosecute relatively small fraud claims in the judicial system. Mr. Richard K. Willard of the Department of Justice (DOJ) said he would prefer an administrative remedy, which he sees as an alternative dispute resolution method, to a judicial remedy for prosecuting small fraud claims due to what he perceives as the inherently higher costs of the judicial system.

It appears that the DOJ has concluded that the adjudication of small fraud claims in an administrative proceeding is substantially more cost-effective than proceedings in the judicial system without giving due consideration to the costs attendant to administrative remedies. An administrative remedy is not necessarily the most cost-effective way of prosecuting small fraud claims. For example, the amount of discovery in a mini-trial, an alternative dispute resolution method, may be greater, at least under certain circumstances, than what would be expected in a typical trial.

Of course, attending increased discovery is increased cost. We believe that the primary factor in determining whether one dispute resolution method is more cost-effective than another is the limitations placed on discovery. Accordingly, alternative dispute resolution methods are not necessarily inherently more cost-effective than litigating a case in the judicial system.

Cost Reduction Possibilities in Judicial Proceedings

It also appears that the DOJ did not seriously consider making the judicial system more cost-effective with respect to small fraud claims as an alternative to the wholesale transfer of such claims to an administrative proceeding. While the government should be cost conscious, even with respect to the judicial system, we do not believe that the judicial system was ever intended to be self-supporting and we certainly do not believe that cost should be the basis for stripping persons of due process rights. This is especially true when, as is the case with this bill, large penalties and assessments can be levied against an individual without proving the extent of damages or, in the case of some false statements, penalties can be levied even though there are no damages.

Even so, we believe that there are ways to reduce the cost of handling small fraud claims. Three possibilities are—

1. to streamline the judicial proceedings for small fraud claims by limiting discovery,

2. to modify the penalties and damage assessments under the civil False Claims Act (31 U.S.C. 3729) and the penalties under the criminal False Claims Act (18 U.S.C. 287) and the False Statements Act (18 U.S.C. 1001) to allow substantial or full recovery of the government's cost of litigation, and

3. to use federal magistrates, special masters, or hearing examiners who are attorneys for small fraud claims.

We do not believe that it would be necessary, as suggested by Mr. Willard during the hearing, for new courthouses to be built in order to handle all the small fraud claims in the judicial system. As stated in the "Program Fraud Civil Penalties Act Factsheet" which is printed in the Congressional Record, May 15, 1985, p. S.6253, one of the purposes of the bill is to deter fraudulent behavior in the future by penalizing such conduct. If everyone knows that small fraud claims will be dealt with and that substantial penalties and assessments can be levied, there are likely to be significantly fewer instances of such claims. Of course, the aforementioned deterrent effect would also decrease the need for additional DOJ attorneys and judges (or hearing examiners, etc.).

In summary, we believe it is appropriate for the government to continue to use judicial proceedings in fraud cases and that it can be cost-effective to do so. However, despite our recommendation to the contrary, we recognize that the Subcommittee may conclude that an administrative remedy is appropriate in such cases. Accordingly, we have addressed specific provisions of the bill, and our recommendations for modifications in these provisions follow at this point.

Proposed Changes to S. 1134

Independence of Hearing Examiners and Reviewing Officials

The reviewing official and hearing examiner should be specified by the bill to be independent of the agency head. That this need for independence is a reality is illustrated by the litigation in the U.S. District Court for the District of Columbia concerning the independence of a hearing examiner with the Merit Systems Protection Board (Fuller v. U.S., No. 84-1699).

With respect to the independence of reviewing officials, we believe that the DOJ essentially has been performing the tasks of a reviewing official: Both the Federal Acquisition Regulation (FAR) (e.g., FAR 3.409(b)(4)) and the Inspector

General Act of 1978 (5 U.S.C. app. §4(d)) require the reporting of fraud and other violations of federal criminal law to the Attorney General. We believe, of course, that the essentials of this process should continue.

During the hearing, Mr. Willard requested that the bill be amended to clarify that agency officials should still have an obligation to report evidence of criminal conduct to the Attorney General. According to Mr. Willard, this would give the DOJ an opportunity to decide whether the case should be prosecuted civilly or criminally. We suggest that the DOJ could, at the same time, decide whether the case should be the subject of an administrative proceeding if it is not selected for criminal or civil prosecution.

To ensure the independence and impartiality of hearing examiners, all hearing examiners should be selected and appointed as full-time administrative law judges (ALJs). This would, of course, require DOD to use ALJs.

As a more cost-effective alternative to appointing ALJs as hearing examiners, we propose that, to the extent possible, already established administrative systems and procedures for adjudicating government program issues be utilized. For example, the Department of Health and Human Services (HHS) has successfully used the Grant Appeals Board to handle a similar administrative remedy program established pursuant to the 1981 Civil Monetary Penalties Law (CMPL), 42 U.S.C. 1320a-7a. The program permits HHS to levy administrative assessments and penalties against those who file false or otherwise improper claims for payment in the Medicare, Medicaid, and Maternal and Child Health programs.

With respect to small false claims relating to government contracts, we suggest that consideration be given to amending the Contract Disputes Act of 1978 (41 U.S.C. 601-613) to permit the Boards of Contract Appeals to hear such cases. The Boards of Contract Appeals are especially suited to hear contract fraud cases because of their special expertise in government contracts. Moreover, if the alleged fraud involves a claim, both the claim and the fraud issue could be resolved at the same hearing.

Pre-hearing Discovery and Right To Subpoena Witnesses During Hearing

Considering the severe penalty and double-damages assessment provisions of the bill, due process requires that respondents be able to subpoena witnesses to testify during the hearing. For the same reason, an agency should be required to provide limited pre-hearing discovery for respondents not only when hearing procedures are promulgated by the agency pursuant to Section 803(f)(2)(F) of the bill, but also if the agency elects to follow the procedures in the Administrative Procedure Act.

Duplication of Remedies

Sections 802(a)(1) and (2) of the bill state that the penalties and assessments of the bill are "in addition to any other penalty that may be prescribed by law." This would authorize the recovery of treble or quadruple damages for a single false claim. For example, with respect to a false claim relating to a contract, a double-damages assessment could be made pursuant to the civil False Claims Act or a single-damages (forfeiture) assessment could be made pursuant to the Contract Disputes Act of 1978 (41 U.S.C. 604) and then a double-damages assessment could be made under the bill. There are many other statutes and regulations under which liability also could be found.

We agree with the position of the American Bar Association (ABA) that the above results were not intended and that the bill should be clarified as follows:

> . . . These provisions should be clarified to provide that while the remedy in this bill does not replace or supercede existing remedies, longstanding principles of election of remedies and merger would apply to bar multiple recoveries on the same set of facts. Any amount recovered in a civil suit, administratively, as restitution, or otherwise, would be credited against the penalties and assessments levied under this bill. This interpretation is consistent with well established rules under the False Claims Act. See United States v. Bornstein, supra; United States v. Thomas, 709 F.2d 968, 972 (5th Cir. 1983); United States v. Foster Wheeler, 447 F.2d 100 (2d Cir. 1971).

Scope of Double-Damages Assessment

The double-damages assessment provision of the bill should be clarified to indicate that it applies to the fraudulent portion of a claim, not the entire claim. This point was made in Mr. Willard's statement on behalf of the DOJ:

> More seriously, we are uncertain about the scope of the double-damages remedy. The bill provides that a person convicted "shall also be subject to an assessment, in lieu of damages sustained by the United States because of such claim, of not more than twice the amount of such claim." §802(a)(1) and (2). This phrase is subject to two interpretations: the damages are equal to either twice the entire amount of the claim, or to twice the amount of the fraudulent portion of the claim. We feel that the latter reading, which is consistent with judicial interpretations of the government's remedies under the False Claims Act, is the preferred one. Under the jurisdictional section, §803(c), this Act may be used for any claim where the amount fraudulently requested is less than $100,000. Thus, a claim for a $20-million airplane which includes a fraudulent request in the amount of $5,000 could be adjudicated under S. 1134. While such fraud should be punished, we think that a $40-million, double-damage assessment clearly would be excessive. We believe that the amount of the penalty should also reflect this jurisdictional limit, lest it be used to assess truly disproportionate penalties.

Jurisdictional Limit

As stated in the last sentence of the preceding quote from the DOJ witness, Mr. Willard, the $100,000 jurisdictional limit should apply not only to the amount fraudulently claimed, but also to the amount of the penalty that may be assessed in order to avoid disproportionate penalties. We agree.

We also believe that the $100,000 jurisdictional limit should apply to any claim or group of claims relating to the same facts or circumstances. This would preclude an agency from avoiding the $100,000 limitation by splitting claims relating to a single set of facts or circumstances into several separate administrative proceedings.

The DOJ should decide whether claims are related for purposes of the $100,000 jurisdictional limit. If our proposal is accepted with regard to the DOJ being the reviewing official, the DOJ could make the above determination in that capacity. In any event the DOJ should make the decision because the DOJ will most likely want to prosecute those related claims totaling over $100,000.

Application of Penalty

Consistent with the above discussion on jurisdictional limits, we believe that claims relating to the same facts or circumstances should be aggregated for assessing a penalty. This would prevent the assessment of disproportionate penalties when numerous invoices or vouchers are submitted with respect to a single false claim involving a small dollar amount or when numerous related false statements are made which cause little or no damage to the government.

Investigating Officials Should Not Have Authority To Subpoena Testimony

The provision in the bill which would provide investigating officials, generally the Inspectors General, with the authority to subpoena testimony should be deleted. Mr. Willard noted the DOJ's objections, with which we agree, as follows:

> . . . Neither the Inspectors General, nor the Federal Bureau of Investigation--the government's principal law enforcement investigatory agency--currently issue investigative subpoenas to compel testimony. The potential for the unlimited exercise of testimonial subpoena powers during investigations might raise due process issues as well as interfere with the criminal investigation process. In addition, there would be no central coordinating authority so as to ensure consistency of standards and implementation. In this manner, section 804(a)(3) could adversely affect coordinated law enforcement. The Administration urges that the Committee delete section 804(a)(3) from the bill.

Debarment and Suspension

We agree with the changes that have been proposed by the ABA to Section 802(b), which would make it clear that a finding of liability under the bill could be considered in a debarment or suspension hearing, but would not be determinative of whether an individual or company should be debarred or suspended. A finding of liability should be only one factor in determining whether an individual or company is presently responsible.

Standard of Knowledge

The bill provides for a standard of knowledge of "knows or has reason to know." It is recommended that "reason to know" be defined in the bill because of the disagreement over the meaning of the term that was exhibited during the hearing. We agree with the ABA and the DOJ that "reason to know" should include "deliberate ignorance" and "recklessness."

However, because a severe penalty and double-damages could be imposed upon a finding of liability under the bill, we do not believe gross negligence or any lower standard of negligence with respect to knowledge should be the basis for a finding of liability. Indeed, we also believe that having a low standard of negligence as a basis for liability might encourage frivolous or exaggerated allegations in connection with the institution of such proceedings.

Conclusion

In closing, we wish to reiterate our basic point that small fraud claims should be handled in judicial proceedings. We do not believe that, for the sake of economy, respondents should be forced to relinquish the due process and jury-trial rights afforded by the judicial system. Moreover, as suggested above, we do believe that the judicial system can be made more cost-effective as applied to the cases under discussion, and without significantly reducing respondents' rights.

In the event our basic recommendation is not adopted, we have offered extensive comments recommending revision of key provisions of the bill, with the objective of establishing an administrative proceeding that is not only cost-effective, but reasonably fair to respondents. Considering the substantial penalty and double-damages assessment provisions of the bill, it is important that the administrative proceeding envisioned have both the appearance and reality of fairness.

* * *

If we can be of further assistance, please let us know.

Respectfully,

Charles Stewart
President

June 18, 1985

COMMENTS OF SPACE COMMUNICATIONS COMPANY ON S.1134

This is written on behalf of Space Communications Company (Spacecom) to express the Company's opposition to S.1134 (introduced May 15, 1985) which would enact the Program Fraud Civil Penalties Act of 1985.

Spacecom is concerned that media-generated hysteria concerning $400 hammers and $600 ashtrays may be driving the Congress to legislative overreach in its attempt to counteract such abuses. We believe that S.1134 is an example of precisely such overreach. From its unsupportable finding that present statutory remedies are inadequate[1/] to its imposition of liability with no scienter requirement[2/] to its restrictions on judicial review of liability determinations,[3/] this is a very bad bill. The single most objectionable provision, however, is the grant of unbounded authority to Inspectors General to compel testimony under oath in aid of their investigations.[4/]

Since enactment of the Inspector General Act of 1978, investigators in ever-increasing numbers have gone forth to search out fraud, waste and abuse in government procurement. While their stated objectives are laudable, their methods are not. There is at present no public visibility into the criteria applied by Inspectors General in deciding whether to conduct an investigation or the procedures followed in weighing the credibility of the anonymous letters and telephone calls that trigger many investigations. Nor is there any significant external review of

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[1/] S.1134, §2(a)(4).

[2/] 5 U.S.C. §802(a)(1), (2), as added by S.1134, §3(a).

[3/] 5 U.S.C. §805(a), as added by S.1134, §3(a).

[4/] 5 U.S.C. §804(a)(3), as added by S.1134, §3(a).

the allocation of investigative assets or use of investigative process by Inspectors General. There are no external controls over the prolonging of investigations beyond reasonable limits, and no mechanism by which persons identified in final investigative reports may be assured of access to such reports.

Thus, at present, an Inspector General may, upon receipt of an anonymous tip, initiate an investigation; cause a target to spend months or years of effort and incur enormous expense in responding to requests for documents and interviews; and close the investigation without so much as advising the affected parties that the investigation has been closed. In short, the Inspector General Act of 1978 may have been noble in its purpose, but it established few practical mechanisms to assure fairness and protect the public against investigative abuse and harassment.

S.1134 places one such mechanism at risk. Under the 1978 law, although Inspectors General may threaten, cajole and intimidate citizens into consenting to interviews, they lack the power to compel testimony by subpoena; absent consent, testimony can now be compelled only by a grand jury. This process, requiring, as it does, the intervention of a U.S. Attorney, provides some degree of reassurance of a relatively detached and impartial evaluation of the merits by an independent and experienced arm of government before the investigatory engine is allowed to develop a full head of steam.

Spacecom believes that the interposition of the U.S. Attorney and the grand jury is essential to protect civil liberties and curb potential investigatory excesses of Inspectors General. The power to compel testimony by subpoena is not available to the Federal Bureau of Investigation or other long-established law enforcement agencies, and there is no articulable reason for granting such authority to Inspectors General. For that reason, Spacecom urges that Section 3(a) of S.1134 be amended to delete paragraph (3) of §804(a) of Title 5, United States Code, which would confer such subpoena authority.

Indeed, Spacecom recommends that the Subcommittee go further. Not only should Inspector General investigative authority not be extended, it should be subject to greater internal control and external oversight than exist at present. In this regard, Spacecom suggests amending the Inspector General Act of 1978 to:

(1) require the issuance of regulations, in the manner prescribed by the Administrative Procedure Act, setting forth standards by which Inspectors General review and establish the credibility and seriousness of allegations, particularly anonymous complaints, before authorizing an investigation;

(2) require Inspectors General to advise prospective witnesses (a) of the nature of their alleged involvement with the subject of the investigation, and (b) that their testimony is not compulsory;

(3) require Inspectors General to draw their investigations to a speedy conclusion and to inform affected individuals that the investigation has indeed been concluded;

(4) require Inspectors General to provide to persons identified in final investigative reports reasonable access to such reports and an opportunity to enter rebuttal statements into the reports.

Such reasonable limitations would serve to inject a measure of fairness into the investigative process that is now lacking, without creating a significant impediment to Inspector General efforts to curb fraud, waste and abuse.

June 18, 1985
STATEMENT OF J. H. McQUISTON
on Program Fraud Civil Remedies

McQuiston Associates
Los Angeles, California 90038

Mr Chairman and Members of the Subcommittee:

McQuiston Associates is a "think tank" which is deeply involved with the Competition in Contracting Act and the Equal Access to Justice Act. Thus I have been involved in fashioning remedies for extrerely complex problems such as Program Fraud.

Program Fraud must be reduced. That is unquestionable. The only issue is how to do so, and where to begin.

Fraud is not reducible by recovering after the fraud was committed. So, fraud reduction really means fraud prevention, which is possible by the interposition of appropriate controls. But most of the Congressional bills would merely divert energy away from such controls, or would attack the wrong target. The target almost invariably should be the government employees who cause the frauds.

Although in its preamble S. 1134 appears to apply to everyone, it is clear that, if nothing else will, the "buddy" system will "protect" government employees from receiving sanctions under its terms. This conclusion derives from testimony offered by government employees speaking on behalf of the bills. They speak only of recovering from "outsiders", as if they constitute the bulk of the problem. But a careful audit shows otherwise.

If, say, a farmer lets a cow into a pasture without proper supervision, and the cow becomes sick, the blame properly rests on the farmer, not on the cow. Likewise, every government disbursement by law is tightly supervised. Government employees take a special oath, to "take Care that the Laws be faithfully executed" (Art II Sec 3). Only if the employees break the covenant of the oath can the overwhelming bulk of frauds occur. If a person in their supervision commits a fraud, the presumption of blame should fall squarely on the government employee. I believe what frauds occur do so because the employee feels no responsibility for them. S. 1134 will if anything tell the employee not to feel responsible. I believe such a policy statement would be a serious mistake. And I believe there is a simple and direct alternative to S. 1134 which this Committee can employ.

The Inspectors General would have us believe that external fraud is very large, but data in the May 30, 1985 Report to Congress by the DOD Inspector General proves that almost all reported fraud & waste is confined within the agency. Of the 7639 cases closed, only some 15% involved in any way non-government personnel. And whenever outsiders were punished, the associated insiders received so relatively-negligible a punishment as to emerge unscathed and ready for the next round of fraud and waste. This discriminate coddling occurred despite the fact that the employees had given an oath to behave themselves and had not.

The IG Report demonstrates unmistakably that, while outsiders may "steal" millions, government employees acting under color of office waste BILLIONS by their deliberate and calculated disobedience of laws and regulations of the United States. Time after time, the IG uncovers Command (not individual) decisions to deliberately ignore or subvert the law of the land.

Thus the first order of business is to protect the United States from its agents. For surely if agents as public exemplars waste BILLIONS, outsiders might be encouraged to chisel thousands.

Let me illustrate with the case of Redstone Arsenal. (This Committee knows of friction over some test equipment which was discussed in S. Hrg. 98-150, Part 4.) The IG by "hot line" was told that the agency was not following the "breakout" laws and regulations. It was ordering, by negotiated sole-source, component parts actually known to be manufactured by a subcontractor and merely "passed through" by the contractor. Two components were studied. "Due to routine destruction of documentation * * * and incomplete procurement history data", the IG was only able to verify that somewhere between $19 and $28 million was wasted on one component, even though there was supposedly "substantial emphasis" on reducing waste by eliminating "pass-throughs".

Redstone attempted the alibi that production scheduling necessitated the pass-throughs. I am familiar with this type of alibi. At one time, Redstone officers swore that parts could not be obtained in ordinary channels in less than 977 days, when in fact the same officers were ordering and receiving the same part in the ordinary channel in about 90 days. The officers had falsely sworn to the long lead time so that the part could be bought non-competitively.

In S. Hrg No 98-1166, a Breakout Procurement Center Representative noted that Tinker AFB had coded a part at 600 days lead-time, which the actual manufacturer was capable of supplying in 28 days.

In the IG Report, many bases were found to be "hoarding" perishable parts, either by miscoding the lead times or by deliberately ignoring the maximum stock limits imposed by Regulations.

At Redstone, stock was procured non-competitively for resale in a very surprising manner. The procurement group deliberately intended to buy from the HIGHEST priced supplier that could be found. From what we have been able to learn, the reason for the almost-million dollar overbuy was because parts procured at $800 each were being forced upon an ally of the United States at almost $2600 each, with no value added. When Redstone learned that the "customer" learned of the vast markup of this and other parts sold to it, the agency frantically tried to cover up the deceit by procuring some stock nearer the $2600 level, rather than to provide rebates for the overcharges already completed. Naturally, the customer was not pleased when it also learned that Redstone had sold it a 20-year supply (at one delivery) of a part which perished after one year in storage. Such treatment of valuable allies cannot help the future well-being of this Country.

I cannot tolerate coddling government employees who, by forsaking their oaths to faithfully execute laws, have degraded their Country and their fellow citizens by committing the greatest crime possible: a Constitutional tort against the people of the United States. Such a horrendous crime cannot be excused nor condoned by Congressional action, nor by the Executive, without committing yet another horrendous Constitutional tort. Congress must be wary of letting Executive personnel "adjudicate" such tortious acts, because the most horrendous of them probably will have had "official" sanction or else they would not have been committed.

Ingrained in the United States' citizenry is Lord Acton's warning: "Absolute power corrupts absolutely". Behind every one of these massive procurement frauds is an exercise of power that the exerciser believed was "absolute".

The Colonists hated displays of "absolute" power and were determined to rid themselves of it. Crown functionaries were despised not because they were evil people but because their decisions were thought to be colored by the fact that they served at the pleasure of the ruler, and their salaries could be affected by over-generous redress of citizens' complaints. Thomas Jefferson, writing in the Declaration of Independence, listed only 18 specific grievances, but one very prominent grievance was:

> "He has made Judges dependent on his Will alone, for the tenure of their offices, and the amount and payment of their salaries."

Madison later remarked that Montesquieu was correct in declaring:

> "Were the power of judging * * * joined to the executive power, the judge might behave with all the violence of an oppressor." The Federalist, No 47.

An interesting fact about bureaucrats is the oft-held belief that while corporations are "monolithic", and a mistake by an employee should be held against the corporate entity and every employee working for it, a mistake by a government employee should not be held against a government. Thus any employee of an agency, they believe, is perfectly capable of rendering unbiased judgment against the agency or his fellow co-workers. This bureaucratic myth is absolute nonsense to everyone but the bureaucracy. But it furnishes an interesting counter-argument to bills such as S. 1134: would Congress permit, say, Ingalls Ship to adjudicate its grievances against Navy procurement officers? Of course it wouldn't. And likewise, Congress shouldn't allow contracting agencies to adjudicate contract arguments in which the agency has a pecuniary interest, whether they be called "fraud" disputes or not.

I believe the Founding Fathers prevented self-adjudication by government personnel when they established in Art III:

> "The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States * * * ; to Controversies to which the United States shall be a Party; * * * ."

and:

> "The judicial Power of the United States shall be vested in one supreme Court, and in such inferior courts as the Congress may from time to time ordain and establish; The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office."

It is true that "legislative courts" bypass the requirements of Art III. But the Supreme Court has restricted their use to cases not requiring the "Judicial Power" of the United States.

These safeguards do not prevent a syncophant of the Executive from being appointed to an Art III bench, thereafter to become a rubber-stamp for the agencies. But Art III certainly insulates the citizenry from such despotic acts of agencies as were alleged in Assn of ALJ v Schweiker, et al, D.D.C. Civil No 83-0124, wherein it was claimed that HHS pressured ALJ's to reduce arbitrarily the number of decisions rendered against HHS or else face removal or unfavorable personnel rating. Clearly agencies can and do act just as despicably as they did in Jefferson's time.

In U.S. v Kowalchuk, 571 F Supp 72, 79 (E.D. Penn 1983), videotape testimony was taken by the Soviets and offered in an Art III court by the U.S. attorney as proof that Kowalchuk should suffer a dire fate. Thus, if the hearing had been conducted by the agency alone, Kowalchuk would have been doomed.

But the Art III judge who heard the case remarked:

> "The testimony of the Soviet witnesses must be viewed with even greater skepticism. * * * [T]he fact remains that these witnesses were all selected and made available by the Soviet government and were under its control; they could scarcely be expected to testify except in support of the charges originally aired by the Soviet government for its own reasons."

Testimony elicited from agency employees in proceedings run by their bosses is similarly suspect. DOJ struggles to stretch the bounds of American jurisprudence to persuade this Committee and perhaps itself that Americans ought to have what most citizens believe is really "commissar justice".

The problem with DOJ's line of argument justifying (or attempting) such a policy for Congress is twofold: (1) is such Constitutional, and (2) if so, would such policy be the wisest course for the United States? DOJ's arguments fall far short of being convincing on either count.

In Northern Pipeline v Marathon Pipe Line, 458 U.S. 50 (1982), the Supreme Court again reminded Congress that the Judicial Power may not be delegated to non-Art III judges, and that the Judicial Power is implicated in every so-called "private" case. It reiterated that just because one party is the United States does not mean that the case is not "private". A close look at prior statutes enabling "legislative courts" to decide issues will show that the charging party will have an option to bring such case instead in a Court of the United States, and so does the opposing party. Thus, the "legislative court" really is the same as a voluntarily-chosen "arbitrator" whose decision may or may not be binding on the parties, and such arbitration has already been construed as not needing the Judicial Power. But most bills now propose requiring all parties to submit to such "arbitration", provided one party is a U.S. agent, and that forced submission the Supreme Court declared was unconstitutional.

DOJ illustrates the point unwittingly, by referring to a prior case: Atlas Roofing v OSHRC, 430 U.S. 442 (1977). Atlas was a case involving "public" right. Therein, an agency was defending the right of a person to work in a safe environment. However, even when Congress enacted the law underlying Atlas it was disturbed about permitting an agency to adjudicate its own case brought as parens patriae, because Congress viewed such procedure as an unfair policy. Thus, it created the OSHRC as a separate agency, to review the complaints brought by the agency as parens patriae. Thus Atlas stands for the proposition that such bills as S. 1134 have been viewed before as unfair in the eyes of Americans. And it was said in Atlas:

> "Our prior cases support administrative factfinding in only those situations involving "public rights", e.g, where the Government is involved in its sovereign capacity under an otherwise valid statute creating enforceable public rights. Wholly private tort, contract, and property cases, as well as a vast range of other cases, are not at all implicated." Atlas at 458.

The "restrictive" or modern theory of sovereignty is operative in every modern nation except Soviet Russia, which of course employs the type of "commissar" justice proposed by the bureaucrats here. The United States unofficially adopted the "restrictive" theory in 1952, when in the "Tate" letter the State Department warned sovereigns they could no longer operate as before. In 1976, Congress in P.L. 94-583 (FSIA) made it "official" that all sovereigns, including the United States and its component States, would henceforth be bound by the "restrictive" theory. Congress of course can now repudiate the theory, but to do so would be a policy retrograde,of major impact because it would be a totalitarian motion.

But S. 1134 proposes an even more-drastic modification. It proposes to authorize the victim of an injury to decide the fate of the alleged injurer:

> "Sec 2 (b)(1) to provide Federal agencies which are the victims * * * with an administrative remedy to recompense such agencies for losses * * *."

Judge Arnold, of the 8th Circuit, testified previously:

> "It is a maxim of the common law that no one should be the judge in his or her own cause, and this maxim ought to apply even more strongly in the case of administrative agencies to which Congress has delegated certain power that in practice amounts to the ability to make law." The Regulatory Reform Act, J-98-65 at 64 (1983).

Surely S. 1134 represents a breakthrough in modern jurisprudence. Next, perhaps rapists, murderers, and sundry other criminals will similarly be sentencable by their victims. And no longer will courts be necessary in our society. The law of the jungle will reign supreme.

We must beware of this attempt to dilute the detachment between litigant and adjudicator. The question to be answered is: Why not permit Art III judges to decide such cases?

The Inspector Generals reduce such cases to economic terms. We shall check the economics they propose, and we shall discover several economic "frauds" within. But is fraud correction, in a setting where government employees violated a sacred oath, really just an economic matter? Is American-style justice to be evaded on an economic basis, thereby giving the truth to those who contend that the rich can "buy" justice? And even if justice is a dollar-and-cents matter, what proof shows that a decision by a "commissar" is more cost-effective than a decision by an Art III judge, not to mention the cost of appealing the "commissar"?

I believe this Committee should disbelieve anyone insisting that Art III judges are not cost-effective. I personally have obtained Art III decisions at almost no expense, and in only a few hours after filing. I defy anyone to show a comparable result in an administrative-agency setting.

I believe excessive cost is inherent in an ALJ system, because they always take more time and expend more resources than will an Art III judge. ALJ's feel themselves to be inferior, because they are inferior. The Constitution says they are. People feeling inferior require more reassurance to reach a decision; hence, ALJ (or magistrate) opinions are always more-fortified with prior "authorities", etc. Such fortification involves more time. Yet, ALJ opinions are still vulnerable to reversal by a "real" judge.

The cost of the forum is reasonably constant. Each side will require expert counsel, for the United States spares no expense and has "deep pockets". But presentation before an ALJ will have to be more thorough (read COSTLY), because of the ALJ's insecurity and because the standard of review for agency decisions is much more severe (for reversal) than for a decision by a "court". Thus a great deal of minutiae will be entered into evidence in an agency case, which would be omitted in a court case. So the agency proceeding will be more costly than a corresponding court action.

Economics thus favors the Art III adjudicator.

How could the Inspectors General possibly think that agency proceedings cost less than court trials? Perhaps it is because of the accounting methods used in their everyday operations. For example, the DOD Report shows IG "Operating Costs" of $386.3 million for 6 months. But accepted accounting procedures require also a listing of the fixed costs as well. The figures reported amount to some $39,928 per year per operating employee. That figure would be too low to include overhead and real and personal property. Thus the IG has "defrauded" us on "overhead", just as he often has vilified others for so doing. But in the immediate context, we see that perhaps such "loose" accounting could be the basis for a claim that "administrative proceedings" are "low-cost," because the real cost is to be hidden away from sight.

Another way "costs" can be minimized in an agency setting is to withhold the proceeding altogether. This Committee should presuppose that withholding will be the process of choice, judging from the process used in prior debarment proceedings. Withholding will be *very* easy under S. 1134. The agency will "propose" an arbitrary assessment, which the assessee will be invited to resist at its *peril*. In a continuing relationship with an agency, no outsider dare accuse an insider of acting unfairly. And the rules for challenging such assessments can be made intentionally costly for the outsider. And of course if an employee were the assessed (a remote possibility), of course the employee must knuckle under. That is why employees lobbied for the protection of the Merit Systems *Protection* Board, and the Special Counsel, in the Civil Service Reform Act of 1978. Nonetheless:

> "[O]ur system of laws does not operate on the principle of the Queen in *Alice in Wonderland*-- 'Sentence first--verdict afterwards'." *Art-Metal v Solomon*, 473 F Supp 1, 8 (D.D.C. 1978).

Accordingly, let us assume that a full-blown agency proceeding will occur. Using the data in the IG Report, we can estimate the cost to the United States for that proceeding. (Of course how the "free lunch" will affect future costs is another matter.)

The IG data shows that *each* investigation costs $13,811 for the 7,639 cases. That does not include overhead and facilities. As a result of the investigations, 492 were referred to DOJ and 2193 were referred to command prosecutors. Thus each case sent to prosecution actually cost $39,293 in "direct" costs, before the prosecutor even saw it. DOJ rejected all but 284, and command rejected all but 1414, making the IG investigation per *actual* prosecution $62,133. The total cost probably amounts to $155,333 if the overhead and facility expense is included.

Litigation cost is extra. Such a case will probably require at least $20,000 to prosecute, $15,000 to defend, and $10,000 for the forum, for a total of $45,000. An *appeal* to an Art III court usually associated with *agency* adjudications would cost an aggregate of $65,000, but for the moment we will concentrate just on the cost at the agency level. Added to the IG cost, the impact on the economy is $200,333 for every prosecuted case.

The Inspectors General advance the argument that more convictions would result if agencies conducted the proceeding instead of relying on DOJ. They imply that partial *agencies* will "convict" more than DOJ. But the IG figures prove the opposite.

It is true that commands decided to prosecute a larger percentage of cases presented to them by IG's (64 percent v 58 percent). Yet even though commands prosecuted 5 times the number of cases than did DOJ, commands obtained convictions in only 75 percent as many actual convictions as did DOJ. To equal DOJ's number of convictions, commands would need to try almost 7 times as many cases! These statistics indicate that agency lawyers definitely should not be allowed to try fraud cases.

The Inspectors General blame DOJ for the fact that so few cases are actually carried to completion. Perhaps the reason is because IG's are not properly preparing cases. If so, the IG is part of the "waste" problem, spending close to a billion just in DOD. And if so, S. 1134 would only help to increase the waste.

The Inspectors General may have a point with respect to manning in the DOJ. But that argument requires a corollary: excess manpower at the agencies. The proper utilization of manpower does not mean excesses should be left within the agencies and denied DOJ. A mere shift removes the "manning" argument.

Shifting manpower to DOJ has been suggested by others. But no one has mentioned the need for expertise when handling fraud cases. The reason why DOJ wins more cases than do commands is probably that specialists are possible at DOJ because of the concentration of cases, whereas commands tend to possess only generalists. This fact is another reason why DOJ should prosecute all fraud cases.

But if DOJ is to handle all these cases, it makes no sense at all to jump from an Art III court to an agency ALJ. Probably the DOJ attorney would end up being the *de facto* judge in such an agency proceeding. Surely that would be terribly unfair. Let DOJ practice before a "real" judge in an Art III court, where any "pendent" matters will be justiciable in one package.

Yet, even DOJ may fail in its Art II Sec 3 duty. What then?

In the E. F. Hutton case, DOJ advanced a similar argument as proposed by the Inspectors General, in dropping criminal prosecution of Hutton employees. America and Congress were outraged. Clearly, economics should not enter into an apologia for evading criminal prosecution in the United States. And the IG Report cited instances where acts by government employees violating federal criminal statutes dwarfed the damages in the Hutton case. And how about the day-to-day extortions of government officials in sensitive positions, like Adm. Rickover, who "request" things of their captive contractors, or demand that contracting officers "ignore" the laws when conducting certain procurements? Where is the "economic" damage here? Surely these people must not go uncorrected, or the system will just get worse and worse. We don't let murderers go unprosecuted because of economic baggage such suits and incarceration bring with them.

A Substitute to S. 1134

Fraud control is not fraud prosecution. Several simple steps can reduce fraud and still keep America clean of "commissar justice".

The first step is to punish severely any government employee who fails to keep his oath to faithfully execute the law. A severe punishment will cause officials to stop putting underlings into compromising situations. Watergate should have taught us all that lesson.

The first roadblock in execution is the Attorney General. Heretofore it was always necessary for agencies to be prosecuted by an outsider. As the Courts have remarked:

> "Unlike the cases involving private or state defendants, the complainants are not merely 'private attorneys general', they are the only attorneys general. DOJ does not sue other federal government agencies * * *." NAACP v Civiletti, 609 F2d 514, 523 (DC Cir 1979), quoting Parker v Califano, 561 F2d 320, 331 (DC Cir 1977).

After Watergate showed how vulnerable the system of justice was to internal obstruction, Congress enacted P.L. 95-521 providing for "independent counsel" per 28 U.S.C. 591 et seq. Inasmuch as the most expensive losses will involve "inside" fraud, and such will probably be agency authorized, these cases probably should be initially referred to an outside counsel for a decision regarding whether DOJ or the independent counsel should prosecute. Such counsel should not be allowed to prosecute cases he decides must be prosecuted by independent counsel. Thus at minimum there will always be two-of-three votes regarding the propriety of the prosecutor.

The agency or employee accused must be presumed innocent, of course, but because the United States is never held in respondeat superior for the acts of any agent, and the potential liability of the agent is not certain, Congress should bar the use of funds, facilities, and services from the defense. If the agent is found blameless, the Equal Access to Justice Act will provide a means for compensating the agent thereafter. Such technique restores a balance to the process before the court.

The most effective way to prevent waste is to make each employee with primary responsibility for an act personally liable therefor. This technique is inadequate if, say, a $50,000 per year man is liable for $500 million. But proper bonding techniques should insure that no employee will lightly treat the responsibility of the job. For example, a "deductible" bond means that the employee will always bear some loss upon dereliction.

Perhaps the impact of loss of control is not apparent. At a trial, one Redstone procurement contracting officer testified under oath that he was responsible for overseeing 300 contracts and 1800 purchase orders in a year, and that he was personally unfamiliar with details in any contract or purchase order, nor with whom they were solicited, and was ignorant of Program Breakouts. In other words, a massive amount of fraud and waste could have occurred under his nose, and he evidently felt no responsibility for any of it.

Backup surveillance on contracts is provided through the Material Inspection and Receiving Report (MIRR or DD-250). It is a DOD regulation that nothing is "delivered" to any of its minions until an agency representative personally certifies that:

> "Procurement quality assurance has been made by me or under my supervision and they conform to contract, except as noted herein or on supporting documents." DD Form 250.

The "authorized government representative" is required to sign this agency certification, after carefully inspecting both the contract clauses and the actual items or services. Payment is withheld otherwise.

This additional pre-acceptance inspection means that if the goods are not according to contract then the agency itself was derelict in its duty to the United States. For example, in the Hearing on Government-Wide Debarment & Suspension Procedures, March 11 & 12, 1981, each example really described a blatant dereliction by the government's own employees. Those employees dishonestly accepted the government's wages without performing their duties. The management also cheated the United States by improper supervision.

Proper fraud control thus requires a cross-check on the contracting and inspection processes. Contracting officers must be made conscious of the liability for poor contracts. Inspectors must be made conscious of the liability for poor goods & services received. A system incorporating these three elements nips fraud before it can be undertaken.

The Competition in Contracting Act revolutionized procurements. Its requirement for "market research" means that if contracts are let *above* market, those responsible will be prosecutable under 18 U.S.C. 1001 and Art II Sec 3. Testimony in S. Hrg 98-1166 alluded to a part previously procured at $120 each for 400 ($48,000), which after allowing competition reached a low of $38.50 each, a saving of 68 percent. And the low bid involved in *Lear-Siegler v Lehman*, 9 Cir No 85-5715, in which the Attorney General claimed CICA was unconstitutional, was about $10 *million*, or 67 percent, lower than the original source. Thus there *must* be an emphasis on proper contracting procedures. Points to guard against are such factors as estimates of needs, insufficient life-data, non-verified usage, forward planning error, and improper lead-time calculation, as well as such factors as knowing the suppliers and potential suppliers. These factors are susceptible to automated data handling.

Inspection being a form of "parole", it raises the question of how to deal with those who misbehave. The Inspectors General assume that misbehaviour requires as remedy a *complete* breach of relations. Thus, they assume that every contact is with an "adversary". The problem with that attitude is that when people are treated as adversaries they *become* adversaries, and when people are treated nicely they respond in kind, with few exceptions. If the United States treats a *citizen* as an adversary, then other citizens will also shun the citizen, because no one else has as much power to control a person's actions. Most citizens believe in "parole" as a way to rehabilitate miscreants. I believe it is better for investigators firmly to *re-direct* fraudulent motions, than to wait until someone will be imprisoned and the value to the United States is lost. The goal is *not* to see how many badges of dishonor can be issued; it is rather to re-direct errant persons so they *perform* better for the common welfare.

Such re-direction may require closer supervision, and such may be an extra expense to the United States. But perhaps a company performs a service which cannot be duplicated for less than $1 million extra. Wouldn't it be effective to station several "parole inspectors" permanently in supervision of that firm, in lieu of putting all its employees on welfare and paying the $1 million extra besides? Of course. And the same technique works at all levels.

Accordingly, I propose to begin by adding to 10 U.S.C. 2393 the following:

"(d) Neither debarment nor suspension shall be in order if the prospective injury which is the purpose of debarment or suspension can be avoided by additional surveillance or by additional inspection by the contracting agency. However, the contracting agency may consider the reasonable cost of the additional surveillance or inspection as a necessary addition to the contractor's bid or offer when evaluating the bidders or offerors, if prior history discloses a reasonable need for such closer contract management.

"(e) Prior to debarment or suspension, the Attorney General shall have made a showing of cause to an appropriate Court of the United States (as defined in Section 451 of Title 28). The Court shall have considered the following factors before deciding the propriety and the length of the debarment or suspension:

"(1) The likelihood of convicting, or the actual prior conviction(s) of, the contractor, providing the offense would materially affect each prospective United States Contract likely to involve the contractor;

"(2) The amount of irreparable damage to be sustained by the agency if the contractor were allowed to continue to contract with the United States;

"(3) The amount of damage the suspension or debarment will cause the contractor and other interested persons, for which the United States may become liable if the suspension or debarment later is determined to be erroneous; and

"(4) The point of minimum prospective injury to the United States, distinguished from any self-interest of the agency."

The foregoing suggestions should serve to clamp down on waste and fraud while not alienating those upon whom the United States must depend. I believe it is a better alternative than the bills proposed to date. It is a completely different way to solve an urgent problem. I hope you can use it.

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